Supreme Court, U.S.
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In The

Supreme Court of the United States

ISAAC LERNER, *et al.*,

Petitioners,

v.

FLEET BANK, *et al.*,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Where a RICO "scheme to defraud," predicated on mail and wire fraud, is directed by a perpetrator at one party, a government agency with regulatory responsibility, with the motive of injuring third parties, and the third parties are injured, may their injuries be remedied consistent with the remoteness standard of proximate cause?

PARTIES TO THE PROCEEDINGS

PETITIONERS

Isaac Lerner; Eli Lerner; Ballyward Investment Company, Ltd.; Jaime Sochacheski; Gaston Limited; Hotel Investors, Inc.; Perky Limited; Abraham Rappaport; Esther Rappaport; Moshe Cohn; Establissement Somer; Joseph Kohn; Chancery Enterprises, Ltd.; Rosdev Enterprises, Ltd.; Rosdev Developments, Inc.; Michael Rosenberg; Bruce Bayroff; Joshua Goldstein; Land Tech at Manalapan LLC.; Theodore Brodie; Meyer Rosenbaum; MR Associates LLC; Ilana Blumkin, As Trustee; Emdee Tours, Inc.; Alexander Hasenfeld, Inc. Profit Sharing Retirement Plan; Pinchos Rubinson; Akiva Leiman; Estate of Boruch Robinson; Chaim Lefkowitz; Rachel Lefkowitz; Naftali Lipshutz; Sarah Lipshutz; Mendel Lipshutz; Feigy Lipshutz; Reisal Bergstein; Michael Konig; Esther Wertenteil; Mark Wertenteil; Morris Friedman; Sarah Friedman; Aaron Wertenteil; Teena Wertenteil; The Regal Trade, S.A.; Vavel Corp.; Chadwick Funding Co., L.P.; Allen Sausen; Leonard Sausen d/b/a Atassco; Keren Hachesed of Monsey, Inc.; Geneva Properties, L.L.C.; Mt. Pleasant Partners; Herschel Kulefsky; Albert David Pearls & Gems, Inc. Defined Benefit Pension Plan; Chai Properties Corp.; Arthur Kurtz; Crestfield Associates, Inc.; Weinreb Management; Howard Mermelstein.

RESPONDENTS

Fleet Bank, N.A.; Sterling National Bank & Trust Company of New York; Republic National Bank of New York (now known as HSBC).

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PETITION FOR A WRIT OF CERTIORARI

Petitioners respectfully pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered on April 16, 2003.

OPINIONS BELOW

The decision of the United States District Court for the Eastern District of New York is reported at 146 F. Supp. 2d 224 (Block, J.) and reprinted in the Appendix to this Petition. (App. 34-51).

The decision of the United States Court of Appeals for the Second Circuit is reported at 318 F.3d 113 (Sotomayor, J.) and reprinted in the Appendix to this Petition. (App. 1-33).

The Order of the United States Court of Appeals for the Second Circuit denying the petition for rehearing before the panel or rehearing en banc is reprinted in the Appendix to this Petition. (App. 55-56).

JURISDICTION

The jurisdiction of this Court rests on 28 U.S.C. § 1254. The judgment of the United States Court of Appeals for the Second Circuit was entered on April 16, 2003. (App. 52-54). Petitioners' timely petition for rehearing was denied on May 7, 2003. (App. 55-56).

STATUTORY PROVISIONS

18 U.S.C. § 1964(c), in relevant part, provides:

> Any person injured in his business or property by reason of a violation of [RICO] . . . may sue . . . in any appropriate United States district court . . . .

18 U.S.C. § 1961, in relevant part provides:

> (1) "racketeering activity" means . . . (B) any act . . . under . . . title 18, . . . United States Code . . . section 1341 (relating to mail fraud), section 1343 (relating to wire fraud). . . .

18 U.S.C. § 1341, in relevant part, provides:

> Whoever having devised . . . any scheme . . . to defraud . . . for the purpose of executing such scheme . . . places in any post office . . . any matter . . . to be . . . delivered by Postal Service . . . shall be fined . . . or imprisoned. . . .

18 U.S.C. § 1343, in relevant part, provides:

> Whoever having devised . . . any scheme . . . to defraud . . . transmits or causes to be transmitted by means of wire . . . in interstate or foreign commerce, any writings, . . . or sounds for the purpose of executing such scheme . . . shall be fined . . . or imprisoned . . . .

STATEMENT OF THE CASE

In brief, the Second Circuit in its decision limited "scheme to defraud" for purposes of the federal mail and wire fraud statutes, 18 U.S.C. §§ 1341, 1343,[1] by, in effect, requiring a "convergence"[2] between the victim to whom a misrepresentation is made and the victim from whom property is obtained; as such, it threatens to preclude all "third-party" frauds under the mail and fraud statutes

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[1] The decisions under mail and wire fraud on the scope of "scheme to defraud" treat the issue identically; for the purpose of this brief, the statutes are the same. *See Carpenter v. United States*, 484 U.S. 19, 25 n.6 (1987).

[2] "Convergence" is sometimes used, and not used. This Petition is about substance, not terminology.

– civilly and criminally. The rule that it adopted *sub silentio* is followed by three circuits, the Fourth, Ninth, and Eleventh Circuits;[3] it is rejected by five, the First, Third, Fifth, Seventh, and Eighth Circuits.[4] Review of this wide-spread conflict between the Circuit Courts of Appeal[5] is required to settle a recurring issue in criminal and civil mail and wire fraud and RICO litigation under important federal statutes that seek to guarantee the integrity of the Nation's marketplace. This Petition presents this Court with an apt vehicle to settle this conflict.[6]

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[3] *See, e.g., Mylan Laboratories, Inc. v. Matkari*, 7 F.3d 1130, 1137 (4th Cir. 1993), *cert. denied sub nom. American Home Products Corp. v. Mylan Laboratories, Inc.*, 510 U.S. 1197 (1994); *United States v. Utz*, 886 F.2d 1148, 1151 (9th Cir. 1989), *cert. denied*, 497 U.S. 1005 (1990); *Johnson Enterprises of Jacksonville, Ind. v. FPL Group, Inc.*, 162 F.3d 1290, 1318 (11th Cir. 1998).

[4] *See, e.g., United States v. Christopher*, 142 F.3d 46, 52-53 (1st Cir.), *cert. denied*, 525 U.S. 1054 (1998); *Environmental Tectonics v. W. S. Kirkpatrick, Inc.*, 847 F.2d 1052, 1055 (3rd Cir. 1988), *aff'd on other grnds*, 493 U.S. 400 (1990); *Procter & Gamble Co. v. Amway Corp.*, 242 F.3d 539, 565 (5th Cir. 2001); *Schacht v. Brown*, 711 F.2d 1343, 1356-58 (7th Cir.), *cert. denied sub nom. Arthur Andersen & Co. v. Schacht*, 464 U.S. 1002 (1983); *Bieter Co. v. Blomquist*, 987 F.2d 1319, 1325 n.4 (8th Cir.), *cert. denied*, 510 U.S. 823 (1993).

[5] *See United States v. Frost*, 125 F.3d 349, 361 (6th Cir. 1997) (split noted), *cert. denied*, 525 U.S. 810 (1998).

[6] This statement of facts is based on the Amended Complaint, excerpted at App. pp. 57-87, which must be accepted as true on a motion to dismiss. *Leatherman v. Tarrant Cty Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 164 (1993). Dismissal was proper only if it is "clear that no relief could be granted under any set of facts that could be proven consistent with the allegations." *H.J. Inc. v. Northwestern Bell Telephone Co., Inc.*, 492 U.S. 229, 249-50 (1989) (RICO). The rules contemplate simple pleadings and "rely on liberal discovery rules and summary judgment to define disputed facts and issues and to dispose of unmeritorious claims." *Swierkiewicz v. Sorema, N.A.*, 534 U.S. 506, 512 (2002). General allegations "are presum[ed] to embrace those specific facts necessary to support the claims." *NOW v. Scheidler*, 510 U.S. 249, 256 (1994) (RICO). Nevertheless, the full Complaint sets

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The Petitioners are individuals, partnerships, corporations, trusts, pension plans and other entities.

Respondent Fleet Bank, N.A., is a federally chartered national bank with its principal place of business in Jersey City, New Jersey; it does business within the Eastern District of New York. Respondent Sterling National Bank and Trust Company of New York is a federally chartered national bank with its principal place of business in New York, New York. Respondent Republic National Bank of New York (now HSBC Bank USA) is a federally chartered national bank with its principal place of business in New York, New York.

Two separate actions (*Lerner* and *Bayroff*) were filed in the district court. They were different only in that one (*Bayroff*) invoked diversity jurisdiction in addition to that over the federal questions. Discovery was stayed pending amendment of the complaints by Petitioners (that was done) and a hearing on motions to dismiss the amended complaints by the Respondents under the Federal Rules of Civil Procedure.

The District Court consolidated the two actions for the purposes of the motions to dismiss and dismissed them. The District Court granted the motions on the ground that Petitioners, "investor-clients" of a dishonest attorney, David Schick ("Schick"), were acting as "investors" in entrusting their money to Schick, for deposit in accounts with the Respondent banks, and, as such, did not have standing to make claims, as victimized "clients," against the New York Lawyers' Fund for Client Protection ("Lawyers'

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out in rich detail the key allegations; thus, they constitute an excellent factual record to resolve the conflict between the Circuit Courts of Appeals identified in this Petition.

Fund"),[7] since they did not fall within the "zone of interest" protected by the Lawyers' Fund. (App. 34-51).[8]

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[7] The Lawyers' Fund is organized under 22 N.Y.C.R.R., Part 7200. The purpose of the Lawyers' Fund "is to promote public confidence in the administration of justice and the integrity of the legal profession by reimbursing losses caused by the dishonest conduct of attorneys admitted and licensed to practice law in the courts of New York State." 22 N.Y.C.R.R. § 7200. The trustees of the Lawyers' Fund are authorized to "investigate claims for reimbursement of losses," 22 N.Y.C.R.R. § 7200.4(c), "coordinate and cooperate with the Appellate Divisions [sic] of the Supreme Court in the investigation of claims," 22 N.Y.C.R.R. § 7200.4(d), "prosecute claims for restitution to which the [F]und may be entitled," 22 N.Y.C.R.R. § 7200.4(h), and pay claims arising out of "the wrongful taking of money, securities or other property belonging to a law client or other person who entrusted it with an attorney admitted to the practice of law in New York," 22 N.Y.C.R.R. § 7200.8(a)(1), subject to a maximum payment of $100,000 per claimant. 22 N.Y.C.R.R. § 7200.13(a).

Under 22 N.Y.C.R.R. § 1200.46, all attorney "special," "escrow" or "trust" accounts, maintained under New York Judiciary Law § 497, are required to be maintained in "a banking institution within the State of New York which agrees to provide dishonored check reports in accordance with the provisions of Part 1300 of the rules of the Appellate Division."

22 N.Y.C.R.R., Part 1300, in relevant part, provides that special bank accounts required by Disciplinary Rule 9-102 (22 N.Y.C.R.R. 1200.46) shall be maintained only in banking institutions which have agreed to provide dishonored check reports in accordance with the provisions of the section; that a dishonored check report by a banking institution shall be required whenever a properly payable instrument is presented against an attorney's special, trust or escrow account which contains insufficient available funds, and the banking institution dishonors the instrument for that reason; that dishonored check reports shall be mailed to the Lawyers' Fund, which must ("shall") forward the dishonored check report to the attorney disciplinary committee for the judicial department or district having jurisdiction over the account holder.

[8] Petitioners' amended complaints alleged to the contrary. *See, e.g., Lerner* Compl. ¶¶ 1, 3, 99, 136, 158, 162, 174, 177, 210, 214, 215, 218, 242, 311, 318 (multiple references to Petitioners as Schick's "clients"); App. at 57 *et seq.*

An appeal followed. The Second Circuit affirmed on "proximate cause" grounds *not argued in the briefs* (that focused solely on the "zone of interest" analysis of the District Court). The Circuit Court held (contrary to the explicit allegations of the amended complaints) that: "Plaintiffs' harm . . . [was] an unintended and unanticipated byproduct of the bank's alleged racketeering activities." (318 F.3d at 124; App.21; *but see, e.g., Lerner* Compl. ¶ 115; App. at 73-75, 78 *et seq.*, esp. 82-83.) "The Lawyer's Fund, not Plaintiffs, was the *target* of defendants' alleged racketeering enterprise." [*Id.* (emphasis added); App. 21.] "Defendants' goal was to 'perpetrate a fraud on the attorney disciplinary system.'" *Id.*; App. 21 (quoting *Lerner* Compl. at p. 122).[9] Accordingly (concluded the Circuit), "Plaintiffs . . . are too far removed from the actual predicate acts committed to recover for any injuries that they suffered." *Id.*; App. at 20.[10]

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[9] The Court is in error; the quotation is not from the *Lerner* Complaint, but the *Bayroff* Complaint. The correct citation to the *Lerner* Complaint is to Compl. ¶ 94. *See* App. at 83.

[10] The *Lerner* (and *Bayroff*) Amended Complaint not only alleges that the Respondents' "motive . . . was to perpetrate a 'fraud on the [attorney disciplinary] system'," as noted by the Court, but also that it was done "so as to avoid investigation of Schick and his suspension and/or disbarment from the practice of law, and thereby prevent the closing of accounts, loan defaults, loss of business, *and claims by Schick's investors.*" *Lerner* Compl. ¶ 94 (emphasis added); App. 83-84. The Complaints also allege, in great detail, Respondents' knowledge when they operated their scheme to defraud the disciplinary system and their motive to defraud the Petitioners as well as the Fund. *Lerner* Compl. ¶¶ 79F-94; App. 80-84. Because the Court of Appeals construed the Complaints *not* to include the Petitioners as "targets" or "intended victims," its holding can only stand for the proposition that, as a matter of law, Petitioners cannot fall within the class who can recover under a third-party fraud, that is, since the Petitioners were not, in the judgement of the Court, the parties against whom the fraud was directed and from whom property was obtained, their injuries are not cognizable under RICO predicated on mail fraud. While not using the terminology of "convergence," as many courts do not, the Court must be taken to have adopted the rule *sub silentio*.

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The fifteen *Lerner* Petitioners (citizens of other States or foreign nations) alleged losses in the aggregate of $18,000,000, proximately caused by the Respondent banks' fraudulent conduct in processing checks that had insufficient funds in the accounts of the Respondents. The forty-seven *Bayroff* Petitioners (citizens of New York) alleged losses in the aggregate of $39,000,000, proximately caused by the Respondent banks' fraudulent conduct in processing checks that had insufficient funds in the accounts of the Petitioners. Schick pleaded guilty in both the Southern and Eastern Districts of New York to bilking approximately $180 million from clients and investors who placed monies with him in "attorney-at-law," "escrow," "special" or "trust" accounts at the banks. Schick's financial empire unraveled in April, 1996. Involuntary bankruptcy proceedings were commenced against him.

Nevertheless, Schick's original intentions were good; his original modus operandi was not criminal; and his investments were profitable; he began to use fraudulent means to "stay afloat" and keep his investor-clients "at bay" only after suffering in 1988 unexpected and unrelated losses.[11] From that point on, Schick and the Respondents

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In *United States v. Evans*, 844 F.2d 36, 38-40 (2nd Cir. 1988), the Second Circuit observed in *dicta* (likewise not using "convergence" terminology) that under mail fraud, the party deceived must also be the party from whom the property is taken; nevertheless, it observed (using "convergence" terminology) in *United States v. Eisen*, 974 F.2d 246, 253 (2nd Cir 1992), that the adoption of the theory was still open. *See also Corcoran v. American Plan Corp.*, 886 F.2d 16, 20-22 (2nd Cir. 1989) [rejecting *United States v. Cosentino*, 869 F.2d 301, 307 (7th Cir.) (third-party fraud), *cert. denied*, 492 U.S. 908 (1989); *see infra*, n.23)]. The matter may now be taken as settled.

[11] Schick bid on distressed mortgage pools at auctions conducted by the Resolution Trust Company and other bank institutions. Schick told Petitioners that, after being awarded a bid to purchase a mortgage pool, subject to at least a 90-day due diligence period, he could resell the same pool to a "take-out buyer" for a substantial profit (usually between 12% and 20%), subject to a due diligence period of fewer than ninety days. If the take-out buyer declined to purchase the pool, he could

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at times performed in "unison." At other times, however, the Respondents engaged in fraudulent conduct separate from Schick for their own motives: in an effort to keep Schick afloat, to make money from his business, and to minimize their losses if he should go under, including avoiding suits by Petitioners. The motive of each Respondent was to defraud the disciplinary system *and* Schick's clients and investors, by avoiding any investigation of Schick (and his *inevitable* suspension or disbarment), thereby preventing the closing of his accounts, causing loan defaults and loss of future business, and giving rise to claims by Schick's investors against them. (*Lerner* Compl. ¶ 115; App. 73-75, 78 *et seq.*, esp. 82-83) Through the Respondents' fraudulent conduct directed at the New York disciplinary system, but engaged in to defraud Schick's clients and investors, including Petitioners, Schick was able to "bounce" approximately 500 "attorney-at-law," "escrow," "trust" and "special" account checks in a three-year period in excess of $34 million without detection by the attorney disciplinary system; thus, Schick's "insolvency deepened"[12] through his own fraudulent conduct *and* the separate scheme to defraud of the Respondents. The gravamen of the Petitioners' RICO claim for relief was the Respondents' separate corruption of the New York State attorney disciplinary system, an association-in-fact RICO

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rescind the original purchase within his own 90-day due-diligence window, at no cost to him or his investors. Schick told Petitioners that to be able to close on a bid, he needed to have on deposit substantial sums of cash – ten percent of the bid – to evidence to the auctioneer his ability to complete the purchases. To collect this "earnest money," Schick solicited funds from Petitioners and assured them that their money would be protected in an *attorney's* "escrow" accounts covered by restrictive legal provisions, including, in some instances, a requirement that no funds could be withdrawn without the signature of the depositors' representative. At the outset, this venture was not a "Ponzi" scheme, as real profits were initially generated by Schick's imaginative investment strategy.

[12] *See infra* text at n.29 (discussing "insolvency deepening").

enterprise, in which the Respondents played a pivotal role. Each Respondent had a legal duty to report to the Lawyers' Fund under 22 N.Y.C.R.R. §§ 1200.46(1) and (2), and 1300.00, as well as its express written contract with the Fund, checks drawn by attorneys on "special," "trust" or "escrow" accounts returned because of insufficient funds. Respondents' scheme to defraud the system *and Petitioners* was conceived and implemented without Schick's involvement; it involved high-level corporate officials, including in one instance, the president and chairman of the board of one of the Respondent banks.

The key to the implementation of the Respondents' scheme to defraud was their failure to report the "bounced" checks to the disciplinary system. In fact, prior to when Schick's financial debacle became public, Respondents collectively and cumulatively did not report a single "bounced check," which they were required to do by law and the contracts between them and the Lawyers' Fund! Petitioners were prepared to prove that had Respondents reported the "bounced" checks, such reports would, in the very ordinary course, inevitably have resulted in Schick's immediate suspension or disbarment *and prevented further losses by the Petitioners*.[13]

Instead of marking the checks "insufficient funds" – which would have required their reporting to the Lawyers' Fund – certain checks were merely marked "Refer to Maker."[14] In other instances, Respondents fraudulently

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[13] Petitioners' Complaints were dismissed prior to discovery; if they suffered any pleading defect on the issue of remoteness, the Court of Appeals should have remanded them to the District Court for repleading and discovery. *See supra* n.6 (pleading standards). Instead, it decided, as a matter of law, Petitioners were "remote"; thus, its holding creates a conflict among the circuits on the issue of third-party frauds, particularly where government regulatory bodies are involved.

[14] By use of "Refer to Maker" to return Schick's checks rather than "Insufficient Funds," Respondents made detection of their separate complicity as well as their involvement in Schick's scam nearly impossible,

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told Petitioners that the checks were returned unpaid simply because there was a "mix-up" (*e.g.*, "a computer glitch at the bank"; "the check was written on the wrong account, Schick will replace it," etc.), rather than "Insufficient Funds." In other cases, Respondents knowingly permitted Schick to use law firm operating accounts (denominated as "attorney-at-law" or similar account) rather than "trust," "escrow" or "special" accounts in order to evade the bounced-check reporting requirements.[15] As such, Respondents fraudulently evaded reporting requirements that would have plainly resulted in Schick's immediate suspension or disbarment, corrupted New York State attorney disciplinary system, and defrauded Petitioners.

In connection with their scheme to defraud the system and the Petitioners, Respondents caused numerous mailings to be sent to Schick, to other banks, and to Petitioners, and as well as making and causing to be made numerous telephone calls, wire transfers and other wire communications, giving their conduct a veneer of legitimacy; these multiple mailings and interstate (and foreign) communications by wire were the predicate acts of mail and wire fraud.

Petitioners, alleging that they were "clients" of Schick, and in reliance upon Schick's admission to the New York Bar and the integrity of the New York's attorney disciplinary system, including the responsibilities of the Respondents, to regulate Schick's conduct, as an attorney, and to

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since "Refer to Maker" checks did not appear on Schick's monthly bank statements, which were mailed to Schick and subsequently turned over to Schick's bankruptcy trustee.

[15] Respondents took advantage of a "gap" in the reporting requirements, knowingly permitting Schick to deposit "escrow" monies into "operating" accounts, then asserting in defense of this action that they had no obligation to report checks "bounced" on these accounts because they were not *labeled* "trust," "escrow" or "special" accounts.

discipline him for misconduct, entered into approximately 167 different transactions with Schick between 1992 and 1996, involving more than 210 separate transfers of funds to Schick. These separate transactions, each involving a separate injury, are pleaded in detail in the Amended Complaints, including the name(s) of the involved Petitioner(s), the nature of the transaction, and the details of the funds transfer, including identification, by Petitioner and by transaction, of the bank, the account, the date of the transfer and the amount. These transactions would not have occurred had Respondents reported the "bounced checks" to the Lawyers' Fund, since it would have quickly led to Schick's disbarment, and brought the fraud to light. Accordingly, but for the Respondents' corruption of the system, and as a purposeful and foreseen consequence of it, Petitioners proximately lost money, again and again.[16]

REASONS FOR GRANTING THE WRIT

I. Conflicting With Other Courts of Appeals, The Second Circuit's Decision Requiring A "Convergence" Between The Victim To Whom A Misrepresentation Is Made And The Victim From Whom Property Is Obtained Requires Review To Settle A Recurring Question In Nation-Wide Litigation Under Important Federal Statutes.

A. Overview Of The Argument.

In *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258 (1992), this Court read "by reason of" in 18 U.S.C. § 1964(c) to embody traditional notions of "proximate cause" on the issue of relative remoteness. 503 U.S.

[16] The Circuit Court conceded that Petitioners' losses were "fairly traceable" to Respondents' misconduct, but, *sub silentio* requiring "convergence," held that the Amended Complaints failed to allege facts sufficient to plead proximate cause as a matter of law. *See* 318 F.3d at 122, n.8; App. 16.

at 265-69 (citing *Associated General Contractors of Cal., Inc. v. Cal. State Counsel of Carpenters*, 459 U.S. 519, 535 (1983) (anti-trust) (AGC)).[17] *Holmes* applied modified anti-trust remoteness factors to RICO.[18] In *Holmes*, the Court reformulated the five *AGC* anti-trust factors into a three-factor standard to fit RICO:[19] (1) the relative "difficult[y]" of "ascertain[ing]" the plaintiff's damage "attributable to the violation" between him and other more immediate victims, (2) the danger that recognizing the less immediate victim's claim would require the "adopt[ion of] complicated rules apportioning damages among Petitioners removed at different levels of injury . . . to obviate the risk of multiple recoveries," and (3) the absence of a "need to grapple with the problems" because more immediate "victims . . . [could] be counted on to vindicate the law as private attorneys general. . . . " *Holmes*, 503 U.S. at 269-70 (citing *AGC*, 459 U.S. at 540-42). As in *AGC*, *Holmes* did not announce a "black letter" rule that would "dictate the result in every case," but reformulated the 19th century "remoteness" rule of the common law (that turned on "direct or indirect" injury and was an analytical or formal "rule") into a 20th

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[17] Under this Court's well-settled jurisprudence, "scheme to defraud" is broadly defined to extend "to a great variety of transactions." *Fasulo v. United States*, 272 U.S. 620, 628 (1926). It "usually signif[ies] the deprivation of something of value by trick, deceit, chicane or overreaching." *Carpenter*, 484 U.S. at 27 (citations omitted). Its fraudulent elements, when they involve representation, must be "material." *Neder v. United States*, 527 U.S. 1, 17-23 (1999). But "scheme to defraud" extends beyond frauds accomplished by misrepresentations, *Grin v. Shine*, 187 U.S. 181, 189 (1902) (embezzlement), and it reaches beyond face-to-face transactions and includes third-party frauds, *United States v. O'Hagan*, 521 U.S. 642, 649-58 (1997) (misappropriation and use of confidential information to trade on securities); *Carpenter*, 484 U.S. at 25-29 (insider trading).

[18] *Holmes* did not deal with the other aspects of "proximate cause."

[19] RICO does not have an "antitrust injury" analogue. *Holmes*, 503 U.S. at 259 n.15.

century "standard."[20] "Labels," which merely tagged outcomes without giving criteria for decision, were no longer to be used – ostensibly – to determine "remoteness."[21] Because "scheme to defraud" in mail and wire fraud encompasses more than misrepresentations or face-to-face transactions, the *per se* "convergence" approach now followed in the Second Circuit cannot be a universal requirement of liability under mail or wire fraud or a requirement of remoteness under RICO. The only acceptable way to determine the issue is to evaluate the *Holmes* factors, which the Second Circuit conspicuously did not, giving them only lip service.[22]

B. Conflicts In The Circuits.

(i) Fourth Circuit Is In Concert.

In *Mylan Laboratories, Inc. v. Matikari*, *supra*, 7 F.3d 1130, the plaintiff, a corporation, attempted to plead a RICO predicated on bribery, obstruction of justice, and

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[20] The distinction between a "rule" (drive 55 mph) and a "standard" (drive reasonably) is brought out in CASS R. SUNSTEIN, LEGAL REASONING AND POLITICAL CONFLICTS 106-08, 110-15, 130-35 (1993).

[21] This Court in *AGC* specifically rejected the labels of "target" and "zone of interests," since such "labels may lead to contradictory and inconsistent results." 459 U.S. at 537 n.33. *See also Henneford v. Silas Mason Co., Inc.*, 300 U.S. 577, 586 (1937) (Cardozo, J.) ("labels . . . are subject to the dangers that lurk in metaphors . . . and must be watched . . . lest they put us off our guard"); *Techt v. Hughes*, 229 N.Y. 222, 244, 128 N.E. 185, 189 (Cardozo, J.) ("To determine whether . . . [a treaty] has . . . [a] character it is not enough to consider its . . . label. No general formula suffices. We must consult in each case the . . . purpose of the specific articles [of the treaty] involved."), *cert. denied*, 254 U.S. 643 (1920).

[22] Petitioners' injuries were not derivative of the Fund's injuries; in fact, the Fund is not only a regulatory body, but also a governmental insurance entity that promised, but only partially, to cover Petitioners' substantial losses; its shoes were cut from the same leather as the Security Investor Protection Corporation in *Holmes*, whose claims were thought derivative of the victims of the RICO fraud.

mail fraud against a series of corporations and individuals, including employees of the Food and Drug Administration (FDA). Plaintiff alleged that the corporations and employees of the FDA conspired to defraud the FDA into granting the corporations permission to market generic drugs and to delay the granting of a similar permission to plaintiff. The district court dismissed plaintiff's pleading on the ground that a conspiracy to defraud the FDA was not cognizable by the plaintiff, even though he was foreseeably injured by it, since "the person allegedly deceived by the misrepresentations must be the same party who was injured by the misrepresentation in order to allege sufficiently the predicate acts of mail and wire fraud." 7 F.3d at 1137 (citing *Mylan Laboratories, Inc. v. Akzo, N.V.*, 770 F. Supp. 1053 (D. Md. 1991), at 1073).

While the Fourth Circuit remanded the case for the filing of additional pleading on other matters, it affirmed the granting of the motion to dismiss on these grounds. *Id.*[23]

(ii) Ninth Circuit Is In Concert.

In *United States v. Utz, supra*, 886 F.2d 1148 the defendant was convicted of mail fraud; he appealed a denial of his collateral attack based on his reading of *McNally v. United States*, 483 U.S. 350, 356-61 (1987) (schemes to defraud are limited to those whose objective is to obtain property; they do not include schemes to deprive

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[23] *Accord, Lifschultz Fast Freight, Inc. v. Consol. Freightways Corp. of Del.*, 805 F. Supp. 1277, 1291-92 (D.S.C. 1992) (RICO predicated on bribery and mail fraud; since false statements were directed toward third parties (rate bureaus, the Interstate Commerce Commission, and other customers), and plaintiff could not show reliance on those representations, injury to plaintiffs was "remote"; citing *Mylan Laboratories, Inc. v. Akzo, N.V., supra*, 770 F. Supp. at 1074 (holding that the person allegedly deceived by the misrepresentations must be the person injured by the misrepresentations).

a government of honest services).[24] During the course of the opinion, the *Utz* court confidently asserted the schemes to defraud require an "intent to obtain money or property from the victim of the deceit" (citing *United States v. Lew*, 875 F.2d 219, 222 (9th Cir. 1989), which in turn relied on *Mitchell v. United States*, 867 F.2d 1232, 1233 (9th Cir. 1989) (reversing a mail fraud conviction, since the indictment did not allege that money or property was to be obtained from the bank that was deceived)).[25]

(iii) Eleventh Circuit Is In Concert.

In *Johnson Enterprise of Jacksonville, Inc. v. FPL Group, Inc.*, *supra*, 162 F.3d 1290, plaintiff, a contractor, filed a RICO suit against a publicly-owned holding company, its subsidiaries, and a cablevision provider; the district court dismissed the RICO suit; the dismissal was affirmed on appeal. 162 F.3d at 1318 ("Because the misrepresentations the defendants are said to have made were directed to the franchising authorities, not JEJ, JEJ lacks standing under Section 1964(c) to prosecute a claim based on such misrepresentations.") (following *Pelletier v. Zweifel*, 921 F.2d 1465, 1499-1500 (11th Cir.) (plaintiff must be target of the scheme to defraud and rely to his detriment on misrepresentation made to him in furtherance of scheme), *cert. denied*, 502 U.S. 855 (1991)).

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[24] The rule of *McNally*, *supra*, was nullified by Congress in 1988 by the enactment of 18 U.S.C. § 1346.

[25] *Accord, Monterey Plaza Hotel Ltd. Partnership v. Local 483, Hotel and Restaurant Employees Union*, 215 F.3d 923, 926 (9th Cir. 2002) (RICO predicated on extortion and mail fraud; motion to dismiss granted and affirmed, since hotel did not allege that union sought to obtain property from the person who was deceived following *United States v. Lew*, *supra*, 875 F.2d at 222.

(iv) First Circuit Is In Conflict.

In *United States v. Christopher*, *supra*, 142 F.3d 46, the defendant was convicted of wire fraud for orchestrating the purchase of two insurance companies and using the assets of the acquired companies to pay part of the agreed purchase price of the companies and to clear liens from property put up as collateral in the purchase transaction itself in violation of promises made to insurance regulators. Both of the acquired companies subsequently went into receivership. On appeal, the defendant contended that he did not violate the wire fraud statute, since the deception of the state insurance regulators did not involve obtaining money or property from the party deceived. 142 F.3d at 52-53 ("convergence"). Noting the split between the circuits, the First Circuit rejected the argument, relying on *United States v. Blumeyer*, 114 F.3d 758, 767-68 (8th Cir.) (rejecting "convergence"), *cert. denied*, 522 U.S. 938 (1997), and rejecting *United States v. Lew*, *supra* (9th Cir., following the rule).[26]

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[26] *See also Systems Management, Inc. v. Loiselle*, 303 F.3d 100, 103-04 (1st Cir. 2002), in which a company won a contract to provide janitorial service to a college; by law, it had to pay not less than a special minimum wage; employees who did not receive the proper wages sued under RICO; employees won in the district court; on appeal, the judgment was reversed; the First Circuit rejected "convergence" caselaw from the Second, Fourth, Sixth, and Eleventh Circuits, including, *Pelletier v. Zweifel*, *supra*; defendant lost his reliance argument (employees did not rely on the false statements made to the college); the court held that reliance was only one way to establish proximate cause ("Reliance is doubtless the most obvious way in which fraud can cause harm, but it is not the only way. . . . ") and that "a reasonably predictable consequence of his mailing was [that], by deceiving the college, [he was able] . . . to continue to underpay his workers"), but won its argument that a "pattern" was not shown.

(v) Third Circuit Is In Conflict.

In *Environmental Tectonics v. W. S. Kirkpatrick, Inc.*, *supra*, 847 F.2d 1052, the defendants bribed Nigerian government officials to win a defense contract. Mailings implementing the fraud were sent to the Nigerian government, not the plaintiffs; the government was the party deceived by the fraud, not the plaintiffs. Yet it was the plaintiff who lost the contract, and it was the plaintiff that was foreseeably injured. ("Convergence" was not present and the case was not argued using that terminology.) Nonetheless, the Third Circuit squarely held that "the plaintiff's complaint of injury from the bribery scheme . . . meet[s] [the proximate cause] standard" of RICO. 847 F.2d at 1067. In fact, the Third Circuit appropriately applied the *same* standard of "proximate cause" to anti-trust *and* RICO. *Id.* at 1066-67.

(vi) Fifth Circuit Is In Conflict.

In *Procter & Gamble v. Amway*, *supra*, 242 F.3d 539, plaintiff brought a RICO suit predicated on mail and wire fraud against a competing corporation, alleging that it circulated false Satanic rumors about it and its home-care products; because of the rumors, it alleged that it lost business to the competitor. ("Convergence" was not present and the case was not argued using that terminology.) Nevertheless, the Fifth Circuit upheld the RICO complaint. *See* 242 F.3d at 565. Since the competitor was the target of the mail and wire fraud, even though the customers were the persons deceived, and the plaintiff properly alleged that it lost business by reason of the scheme to defraud its customers, its RICO claim was, therefore, cognizable.[27]

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[27] *See also Sandwich Chef of Texas, Inc. v. Reliance National Indemnity Insurance Co.*, 319 F.3d 205, 224 n.13 (5th Cir. 2003)

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(vii) Seventh Circuit Is In Conflict.

In *Schacht v. Brown*, *supra*, 711 F.2d 1343, plaintiff, director of insurance of Illinois and liquidator of insolvent insurance companies, brought a RICO suit in his status as liquidator of an insolvent insurance company predicated on mail fraud that consisted in sending false financial statements to the regulators that had the consequence of prolonging the life of the insurance company. ("Convergence" was not present and the case was not argued using that terminology.) Nevertheless, the Seventh Circuit upheld the theory of the complaint. First, it recognized the damage theory of prolongation of the life of a corporation beyond its insolvency. 711 F.2d at 1349. Then, it turned aside efforts to interpret RICO to exclude "business fraud." *Id.* at 1353-55. ("If Congress wishes to avoid the inclusion under RICO's umbrella of 'garden variety' fraud claims involving the operation of enterprises through mail and securities fraud, it may do so through removing mail and securities fraud from the list of predicate acts enumerated in § 1961. That is not, however, a program which may be undertaken by this court.").[28] Finally, the court upheld the theory of the complaint that the insurance company represented by the liquidator "suffered [cognizable damage within RICO] from the defrauding of the State Department of Insurance which permitted . . . [the defendants] to cause . . . [the insurance company] to continue to operate beyond its insolvency and to allow . . . [the insurance company] to be further drained of its income and more favorable business." *Id.* at 1359. *See also id.* ("Equally fatuous is the suggestion of some of the defendants that they may not be held liable for damage arising from the fraudulent operation of . . . [the insurance company] since . . . [its] immediate injury stemmed from the Illinois

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(*certiorari petition filed May 28, 2003)* (RICO fraud on regulator that injures another legally possible, but not shown on facts as alleged).

[28] *See infra* n.62 (Congress, in fact, took securities fraud out of civil RICO in 1995).

Department of Insurance's assent for . . . [the insurance company's] continued operation. Such an argument plainly confuses *cause* with *result,* for the fraudulent operation of . . . [the insurance company] was surely the alleged progenitor of . . . [the insurance company's] damage, regardless of whether the state regulatory authority was a necessary instrument in the accomplishment of that end.") (emphasis added). *Compare Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*, 267 F.3d 340, 345-46 (3rd Cir. 2001) (upholding, under Pennsylvania law, after citing multiple decisions, including *Schacht v. Brown*, *supra*, the theory of damage known as "deepening insolvency" in a suit brought by a bankruptcy committee against third parties, including outside professionals).[29]

(viii) Eighth Circuit Is In Conflict.

In *Bieter Co. v. Blomquist*, *supra*, 987 F.2d 1319, plaintiff, a commercial developer lost a zoning battle because of a bribery that was part of a complex "scheme to defraud." It then brought a RICO suit. The district court

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[29] *See also United States v. Cosentino*, *supra*, 869 F.2d at 307 (defrauding State Insurance Department about financial solvency of an agency, thereby permitting it to continue beyond the point at which the Insurance Department would have closed it down, so that money could be drained from it during the extended period, cognizable as scheme to defraud under mail fraud statute) (relying on *United States v. Bailey*, 859 F.2d 1265, 1277-78 (7th Cir. 1988) (RICO predicated on mail fraud conviction upheld where scheme to defraud Federal Home Loan Bank Board and Federal Savings and Loan Insurance Corporation about the declining assets of a bank was intended to give the defendants additional time to bilk the assets of the bank), *cert. denied sub nom. Ticktin v. United States*, 488 U.S. 1010 (1989). In light of these decisions, terming Petitioners' Complaints at bar "creative," drafted with "ingenuity," or "novel," 318 F.2d at 116, 118, 119, is not accurate; had the arguments on appeal been directed by the Court of Appeals before briefing toward these issues (not addressed by the District Court), the Circuit Court might not have so grievously erred, thereby exacerbating the conflict between the Circuits and giving rise to this Petition.

dismissed the complaint because of lack of "proximate cause." ("Convergence" was not present and the case was not argued using that terminology.) Nevertheless, the Court of Appeals reinstated the RICO claim for relief. Properly applying the three *Holmes* factors to distinguish between "near" and "remote" RICO claimants, the Court of Appeals found that "proximate cause" was, under the circumstances, a matter of fact for the jury. 987 F.2d at 1326-27. In brief, it held that the district court adopted an "excessively narrow view of causation and injury," 987 F.2d at 1320, that "would not be consistent with purposes of RICO," to wit, "to root out public corruption." *Id.* at 1329.[30]

C. The Second Circuit's Standard Under A RICO Scheme To Defraud, Limiting Recovery To The Victim To Whom The Misrepresentation Is Made And From Whom The Property Is Obtained And Precluding Recovery By Other Victims Who Were Purposely Injured, Is Inconsistent With The Text of The Mail Fraud Statute, The Text Of RICO, Congressional Purpose, And The Teachings Of This Court.

The roots of the Second Circuit's error in this case lie in its confusing various kinds of "fraud," a term as Prosser

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[30] *See also Atlas Pile Driving Co. v. DiCon Fin. Co.*, 886 F.2d 986, 991 (8th Cir. 1989) (plaintiffs were subcontractors that were not paid; the general contractor was a straw man that fraudulently borrowed funds for the job and paid itself, but then defaulted on the loans; the court upheld the RICO mail fraud theory of the complaint, though at trial common law fraud claims were *dismissed* for a lack of necessary elements (misrepresentation, reliance, etc.), since it was premised on a "scheme to defraud" that did not have to meet the common law elements); *United HealthCare Corp. v. Am. Trade Ins. Co. Ltd.*, 88 F.3d 563, 571 n.5 and 572 (8th Cir. 1996) (plaintiffs' insurance premiums were misappropriated through a complex, multiparty "scheme to defraud"; a RICO claim for relief was upheld without requiring a showing of misrepresentation or reliance to establish "proximate cause").

so ably teaches, that is "so vague that it requires definition in nearly every case." WILLIAM PROSSER *et al.*, LAW OF TORTS 727 (5th ed. 1984). The Second Circuit conflates "scheme to defraud" under federal law[31] with common law "obtaining money by false pretenses," a crime, and common law "deceit," a tort – each of which contain misrepresentation and reliance elements – with common law "cheat," a crime that required an "intent to defraud" and a false symbol or token – but neither misrepresentation nor "convergence"; and it is not limited to face-to-face transactions – and "conspiracy to defraud," a crime. Decisions and treatises at the time refer to the common law action for misrepresentation, not as "fraud," but "deceit."[32] When "fraud" alone is used, it signifies a much broader range of overreaching conduct.[33] In fact, "scheme to defraud" in federal law stems from a careful statutory blend of common law "cheat" and "conspiracy to defraud."[34] Cheating – without misrepresentation, "convergence" or a face-to-face transaction – suffices to establish a "scheme to defraud."[35]

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[31] The phrase appears in up to 500 federal statutes as well as 50 sections of Title 18. *Mail Fraud: Hearings on H.R. 3089 and H.R. 3050 Before the Subcomm. on Crim. Justice of the House Judiciary Comm.*, 100th Cong. 2nd Sess. 17 (1988) (Testimony of Acting Assistant Attorney General John C. Keeney).

[32] *See, e.g.*, JOEL BISHOP, COMMENTARIES ON THE NON-CONTRACT LAW 132-44 (1889); FREDERICK POLLOCK, A TREATISE ON THE LAW OF TORTS 348-88 (1894).

[33] *See, e.g.*, MELVILLE BIGELOW, THE LAW OF FRAUD 3-4 (1877); WILLIAM ANDERSON, A DICTIONARY OF LAW 474-78 (1889).

[34] *See* Courtney Chetty Genco, *Whatever Happened to Durland: Mail Fraud, RICO, and Justifiable Reliance*, 68 NOTRE DAME L. REV. 333, 337-64 (1992).

[35] As common law "false pretenses" or "deceit" does not, "scheme to defraud" includes making promises with an intent not to perform, *United States v. Comyns*, 248 U.S. 349, 353 (1919), and embezzlement, *Grin v. Shine*, *supra*, 187 U.S. at 189. *See generally* ROLLIN M. PERKINS *et al.*, CRIMINAL LAW 292-342, 351-388 (3rd ed. 1982); CLARK & MARSHALL, LAW OF CRIMES 706-780, 795-840 (6th ed. 1958) (Melvin F. Wingersky ed.) (*Clark & Marshall*).

In short, courts read mail fraud to forbid schemes to defraud that involve false representations and schemes to defraud that do not.[36] Accordingly, the elements of "scheme to defraud" may be simply set out. The defendant must act with "intent to defraud." *Durland v. United States*, 161 U.S. 306, 312-14 (1896). Good faith is an absolute defense. *Id.* He or she must formulate his or her "scheme."[37] "Scheme" is "sufficiently general" to reach a broad range of illicit activity.[38] The perpetrator must intend the result of his or her scheme, that is, he or she must intend to deprive another of something of value, or to gain a benefit for himself or herself by means of deprivation or gain. *Carpenter*, 484 U.S. at 27.[39] "Intent . . . make[s] an otherwise innocent act criminal, if it is a step in a plot." *Badders v. United States*, 240 U.S. 391, 394 (1916) (mail fraud) (Holmes, J.). Apart from the jurisdictional elements (mail, wire, etc.), "scheme to defraud" *requires* nothing else; it may be implemented through a variety of techniques, including, *but not limited to*, representations, etc.[40] A

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[36] *See, e.g., Murr Plumbing v. Scherer Bros. Fin. Serv. Co.*, 48 F.3d 1066, 1069 n.6 (8th Cir. 1995) (RICO mail fraud); *Formax, Inc. v. Hostert*, 841 F.2d 388, 390 (Fed. Cir. 1988) (RICO mail fraud).

[37] *United States v. Massey*, 48 F.3d 1560, 1566 (10th Cir.) ("A scheme refers to the overall design to defraud one or many by means of a common plan or technique."), *cert. denied sub nom. Wilkins v. United States*, 515 U.S. 1167 (1995).

[38] *See, e.g., United States v. Maze*, 414 U.S. 395, 399 n.4 (1974) (mail fraud's "scheme to defraud" applicable to a credit card scam, even though credit cards were not in existence in 1872, when it was drafted).

[39] The "contemplated" loss need not even be easily measurable. *See, e.g., United States v. Richman*, 944 F.2d 323, 329-31 (7th Cir. 1991) (loss of an opportunity to bargain because a lawyer plotted to pay an insurance agent to settle a claim).

[40] In contrast with this Petition, *see* the general language properly used by the Second Circuit in *United States v. Trapilo*, 130 F.3d 547, 551 (2nd Cir. 1997) (scheme to defraud Canadian Government out of cigarette tax revenue) ("Under both the mail and wire fraud statutes, '[t]he thing which is condemned is (1) the forming of the scheme to defraud, *however and in whatever form it may take*, and (2) a use of

(Continued on following page)

comprehensive definition of "scheme to defraud" "need not be undertaken," *Fasulo*, 272 U.S. at 628, and it has not.

The Second Circuit's test cannot be squared with the text of the statute or modern conceptions of "fraud." The statute (18 U.S.C. § 1341) says "any" fraud. "Any" means "all" not "some, but not others."[41] No convincing policy justification can be – or has been – offered to support a "convergence" theory in our modern society that is unfortunately characterized by complex, multiple party frauds, particularly in a society where governmental regulatory bodies proliferate. The court's *sub silentio* adoption of the discredited[42] philosophy of *caveat emptor* is unwarranted.

Fundamentally, the Second Circuit's rule misunderstands *Holmes*. Factual ("but for") cause is, of course, by itself insufficient. 503 U.S. at 265. In each instance, other policy consideration must be examined to determine the proper extent of liability. *Id.* at 266.[43] But no "black letter rule [or label like "target"] . . . will dictate the result in every case." *Id.* at 274 n.20 (citing *AGC*, 459 U.S. at 536). "Schemes to defraud" may of course, involve simple, face-to-face misrepresentation fraud. Nevertheless, even here, "proximate cause" may require an analysis of not only *transaction* (how did you get into the relationship?), but also of *loss* causation (why did you suffer the loss?).[44] Proof of

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[mail and wire communications] in its furtherance. *If that is satisfied, more is not required.*") (citations omitted; emphasis added), *cert. denied sub nom. Pierce v. United States*, 525 U.S. 812 (1998).

[41] *See, e.g., Mobil Oil Exploration & Producing Southeast, Inc. v. United Distribution Cos.*, 498 U.S. 212, 223 (1991).

[42] *See SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963); MAX RADIN, THE LAWFUL PURSUIT OF GAIN 54 (1931) ("[C]aveat Emptor . . . is bad Latin, and from the Roman point of view, worse law.").

[43] *See supra* text at n.13 *et seq.*

[44] *See, e.g., Bastian v. Petren Resources Corp.*, 892 F.2d 680, 685 (7th Cir.) (RICO; while transaction and loss causation may merge, each must be shown; fraud that induces entry into oil and gas partnership establishes transaction causation, but where the fraud is unrelated to

(Continued on following page)

"convergence" may or may not show transaction causation.[45] Loss causation is another matter, which must, of course, be independently established.[46] Remoteness, too, is another matter, a matter of weighing factors in choosing between victims to select the one in the "best position" to enforce the federal statute at issue. *Holmes*, 503 U.S. at 269; *AGC*, 459 U.S. at 541-45; *Kansas v. Utilcorp United Inc.*, 497 U.S. 199, 214 (1990) (anti-trust); *California v. ARC America Corp.*, 490 U.S. 93, 102 n.6 (1989) (anti-trust).[47] No plaintiff's claim should be, as here, denied under a "remoteness" analysis when the denial is "likely to leave a significant violation [of federal law] undetected or unremedied." *AGC*, 459 U.S. at 542.

But "scheme to defraud" may also involve a third-party fraud, where the fraud (*e.g.*, a misrepresentation or a bribe) is worked on one entity, say, a rate-setting commission – that may or may not itself suffer a property loss – where a loss is then suffered by a third person, say, a rate-payer; a gain inures to the perpetrator, say, a utility – a result that is intended (or at least foreseen), but the loss and the gain need *not* be identical; they need only be related. Here, a "convergence" requirement (a misrepresentation to

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the decline in market value, loss causation is not established) ("If the plaintiffs would have lost their shirts in the oil and gas business regardless of the defendants' violations of RICO, they have incurred no loss for which RICO provides a remedy."), *cert. denied*, 496 U.S. 906 (1990).

[45] *Compare Metromedia Co. v. Fugazy*, 983 F.2d 350, 368 (2nd Cir. 1992) (RICO; reliance in face-to-face misrepresentation fraud shows proximate cause between fraud and injury), *cert. denied*, 508 U.S. 952 (1993), *with Ideal Dairy Farms, Inc. v. John Labatt, Ltd.*, 90 F.3d 737, 746-47 (3rd Cir. 1996) (RICO; where plaintiff knew of overcharges, no proximate cause between face-to-face misrepresentation fraud and injury).

[46] *See Bastian*, *supra* n.37.

[47] *See Sports Racing Serv., Inc. v. Sports Car Club of Am., Inc.*, 131 F.3d 874, 889 n.15 (10th Cir. 1997) (anti-trust) ("best position to identify . . . [a violation] and the most incentive to bring an action").

the victim who suffers the loss) would preclude recovery, and it is not required.[48] Instead, "proximate cause" must be shown – and it is – by the use of this Court's general "proximate cause" standards.[49]

The Second Circuit's *per se* preclusion of the recovery for injury suffered by a third-party – whose injury was a motive of the scheme, and it was foreseen and foreseeable – where the fraud is directed to another party, particularly a government agency that performs a regulatory function, is a misguided importation of a discredited 19th century *laissez faire* limitation on civil "deceit" into the modern law of "scheme to defraud" – a standard here used in a *criminal* statute. It adopts (though not explicitly) the discredited common law limitation imposed in *Peek v. Gurney, L.R.*, 6 Eng. & In. App. 377 (1873), in which Lord Cairns held that a speaker who makes a misrepresentation is civilly liable only to whom he "desired" to influence (the principal listener) by the representation in the fashion that occasioned the injury; absent extraordinary circumstances, third parties may not recover.[50] Limitations – misguided or not – on civil "deceit" "plainly have no place" in establishing a "violation" of "scheme to defraud." *Neder, supra*, 527 U.S. at 23. Nor should they affect civil

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[48] The example in the text is taken from *Holmes* itself, which it used to illustrate a third-party fraud that might properly establish proximate cause for its victims under the Court remoteness teachings. 503 U.S. at 279 n.19.

[49] *Id.* Third-party fraud situations, as here, typically involve a fraud on governmental entity. *See, e.g., Bieter, supra*, at 1325 n.4 (bribery; zoning board); *Environmental Tectonics, supra*, at 1055 (bribery; foreign government). Representations may well not be made, and "convergence" is not present, yet a violation of mail fraud is found, and a recovery is authorized under RICO. Thus, the Second Circuit's decision undermines a central purpose of RICO: control of public "corruption" (engaged in by organized crime or not). Statement of Findings and Purpose, P.L. No. 91-452, 84 Stat. 922-23 (1970).

[50] *Peek* is analyzed and criticized on its own terms in W. Page Keeton, *The Ambit of Responsibility for Fraud: Representator's Liability*, 17 TEX. L. REV. 1 (1938) and *Prosser* at 743-45 (5th ed. 1984).

liability. *American Society of Mechanical Engineers v. Hydrolevel Corp.*, 456 U.S. 556, 568-69 (1982) (anti-trust) ("Victorian" common law limitations inappropriate on private enforcement of anti-trust statutes.).[51]

When this Court, in *AGC*, took up "proximate cause" in anti-trust litigation, it specifically criticized and rejected the use of "labels" to decide remoteness questions. 459 U.S. at 528-35 & n.33 ("directness," "zone of interests," and "target"). Instead, lower courts in future were to "analyze each situation in light of the five . . . factors" that the Court identified in its opinion. *Id.* In *Holmes*, the Court reformulated the five *AGC* factors for "remoteness" in anti-trust into a three-factor standard for "remoteness" in RICO. 503 U.S. at 269-70 (citing *AGC*, 459 U.S. at 540-42). "Labels," which merely tag outcomes, without giving criteria for decision, were no longer to be used to determine "remoteness." In fact, RICO and anti-trust overlap.[52] "Proximate cause" – with special anti-trust modifications – is the same under RICO and anti-trust.[53] Yet third-party recovery without "convergence" is routinely upheld in anti-trust litigation.[54]

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[51] In fact, results in common law decisions were not uniformly consistent with *Peek*. *See, e.g.*, *Bohannon v. Wachovia Bk. & Trust Co.*, 210 N.C. 679, 683, 188 S.E. 390, 394 (1936) (testator deceived into disinheriting plaintiff; plaintiff has claim for relief against perpetrator); *accord* RESTATEMENT OF TORTS (Second) § 774B (1979); *Mitchell v. Langley*, 143 Ga. 827, 831, 85 S.E. 1050, 1051 (1915) (holder of life insurance policy defrauded into switching beneficiary; beneficiary has claim for relief against perpetrator).

[52] *See, e.g.*, *Environmental Tectonics*, *supra*, at 1067 (antitrust and RICO recovery upheld in bribery by bidder of foreign government).

[53] *Holmes*, 503 U.S. at 269-70.

[54] *See, e.g.*, *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 495-96 (1988) (manufacturer of plastic conduit could sue manufacturer of steel conduit that improperly influence a trade association, which, in turn, promulgated a safety code that contained false product safety information about plastic conduit, which, in turn, influenced market participants either not to use plastic conduit or to disapprove its use by others).

II. Mail And Wire Fraud And RICO Are Important Federal Statutes Whose Fairness And Effectiveness Are Undercut By Conflicting Decisions Of The Circuit Courts Of Appeals.

A. Mail And Wire Fraud.

First enacted in 1872, the mail fraud statute is the progenitor of the federal fraud statutes codified in Title 18 in 1948.[55] Wire fraud was added as a separate crime in 1952. "[These statutes] have been regularly enforced by executive officers and the courts for more than half a century. They are now part and parcel of our governmental fabric." *Donaldson v. Read Magazine, Inc.*, 333 U.S. 178, 190 (1948) "During the past century, both Congress and [this] . . . Court have repeatedly placed their stamp of approval on expansive use of the mail and wire fraud statutes."[56] These fraud statutes serve as a "'stop-gap' device which permits the prosecution of newly-conceived fraud until such time that Congress enact[s] particularized legislation to cope with the new frauds."[57]

B. RICO.

In 1970, Congress enacted RICO to deal with "enterprise criminality."[58] Like the antitrust statutes, Congress

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[55] In fact, 18 U.S.C. § 371, first enacted in 1867, used "scheme to defraud." "There is no basis[, however,] for concluding that the term 'defraud' means something different in § 1341 . . . than what it means in § 371. . . . " *McNally v. United States*, *supra*, 483 U.S. 350, at 369 (Steven, J., dissenting).

[56] Jed S. Rakoff, *The Federal Mail Fraud Statute* (Part I), 18 DUQ. L. REV. 771, 772 (1980).

[57] *United States v. McNeive*, 536 F.2d 1245, 1248 n.5 (8th Cir. 1976) (citing *United States v. Maze*, *supra*, 414 U.S. 395, at 405-06 (Burger, C.J., dissenting)).

[58] *United States v. Cauble*, 706 F.2d 1322, 1330 (5th Cir. 1983) ("enterprise criminality" consists of "all types of organized criminal behavior [ranging] from simple political corruption to sophisticated

(Continued on following page)

used in RICO "a generality and adaptability [of language] comparable to that found to be desirable in constitutional provisions." *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 359-60 (1933) (anti-trust). Congress "drafted RICO broadly enough to encompass a wide range of criminal activity, taking many different forms, and likely to attract a broad array of perpetrators operating in many different ways." *H.J. Inc. v. Northwestern Bell Telephone Co., Inc.*, *supra*, 492 U.S. 229, at 248-49. "The occasion for Congress' action was the perceived need to combat organized crime. But Congress for cogent reasons chose to enact a more general statute." *Id.* at 248. Like the anti-trust, RICO creates "a private enforcement mechanism that . . . deters[s] violators [;] deprives them of the fruits of their illegal actions and . . . provide[s] ample compensation to the victims of [RICO] violations." *Blue Shield of Va. v. McCready*, 457 U.S. 465, 472 (1982) (antitrust) (citing *Pfizer, Inc. v. Gov't of India*, 434 U.S. 308, 313-14 (1978)); *Rotella v. Wood*, 528 U.S. 549, 558 (2000) (" 'private attorneys general' dedicated to eliminating racketeering activity. * * * The provision for treble damages is accordingly justified by the expected benefit of suppressing racketeering. . . . "). Like the anti-trust statutes, "RICO is to be read broadly." *Sedima, SP.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, 497-98 (1984); *American Society of Mechanical Engineers, Inc.*, *supra*, 456 U.S. at 568-69 (anti-trust). Indeed, RICO makes its principle of liberal construction a matter of *express* statutory language. 84 Stat. 947 (1970).

A substantial portion of civil RICO litigation enforces federal "scheme to defraud" standards. *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, 483 U.S. 143, 149 (1987). Because of RICO's "pattern" element, an enforcement action can often be brought in more than one circuit. *See* 18 U.S.C. § 1965 (nationwide venue and service of

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white-collar schemes to traditional Mafia-type endeavors.") (citations omitted), *cert. denied*, 465 U.S. 1005 (1984).

process provisions). Motions to transfer will have as their real reason, not "the correct" or "a more convenient" forum, but to obtain a more favorable circuit law.[59]

Conflicts on these key (and closely interrelated) elements of liability under mail or wire fraud and proximate cause under RICO – "violation" and "by reason of" – are intolerable. They are raised in virtually all "scheme to defraud" litigation, whether under the fraud statutes, criminally, or civilly under RICO. To permit this issue to fester any longer is not fair to litigants in different circuits, and it undermines RICO's effectiveness, criminally and civilly, as a guarantor of integrity of the country's national marketplace,[60] an issue sadly in the headlines every day in the context of corporate fraud.[61]

If mail and wire fraud or RICO is to be limited, as attempted here by the Second Circuit, that reform ought to come from Congress. *H.J. Inc.*, 492 U.S. at 249.[62] Congress, the proper body, has *not* enacted *general* limitations on RICO's enforcement of "scheme to defraud." That ought

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[59] *Tel-Phonics Services, Inc. v. TBS Int'l, Inc.*, 975 F.2d 1134, 1138 (5th Cir. 1992) (RICO; law of transferee circuit applied). *See generally Wisland v. Admiral Beverage Corp.*, 119 F.3d 733, 735-36 (8th Cir. 1997), *cert. denied*, 522 U.S. 1112 (1998).

[60] "There are three possible kinds of force which a firm can resort to: violence (or threat of it), deception, or market power" CARL KAYSEN *et al.*, ANTITRUST POLICY 17 (1959). Anti-trust focuses on the third; "scheme to defraud" focus on the second; RICO focuses on the first and second. Together, they seek a market place characterized by integrity, fiscal and physical.

[61] The litany of major company names in the news is dizzying. *See, e.g.*, *The Economist*, June 28, 2003 (Enron, WorldCom, Tyco, Adelphia, HealthSouth, ImClone, Global Crossing, etc.) ("[T]he basic task is to insure that existing laws are vigorously enforced and that any loopholes in them are closed . . . . ").

[62] Congress still sits; it can – as it has – amend RICO. *See, e.g.*, the Private Securities Litigation Reform Act of 1995, Pub. L. 104-67, § 107, *amending* 18 U.S.C. § 1964(c) (conduct actionable as securities fraud may not be grounds for recovery under RICO).

to end the matter judicially, absent constitutional considerations not implicated here. *United States v. Turkette*, 452 U.S. 576, 587 (1981) ("There is no argument that Congress acted beyond its power. . . . That being the case, the courts are without authority to restrict the application of . . . [RICO]"). Justice Cardozo put it well: "[A court's] duty is done when . . . [it] enforce[s] the law as it is written." *Techt v. Hughes*, *supra*, 229 N.Y. 222, at 228-29.

CONCLUSION

For these reasons, Petitioners respectfully urge this Court to grant their Petition for a Writ of Certiorari.

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LEXSEE 2003 U.S. App. LEXIS 946

ISAAC LERNER, ELI LERNER, BALLYWARD INVESTMENT COMPANY, LTD., JAIME SOHACHESKI, GASTON LIMITED, HOTEL INVESTORS, INC, PERKY LIMITED, ABRAHAM RAPPAPORT, ESTHER RAPPAPORT, MOSHE COHN, ESTABLISSEMENT SOMER, JOSEPH KOHN, CHANCERY ENTERPRISES, LTD, ROSDEV DEVELOPMENTS, INC., MICHAEL ROSENBERG, BRUCE BAYROFF, JOSHUA GOLDSTEIN, LAND TECH AT MANALPAN LLC., THEODORE BRODIE, MEYER ROSENBAUM, MR ASSOCIATES LLC., ILANA BLUMKIN, As Trustee, EMDEE TOURS, INC., ALEXANDER HANSENFELD, INC., PROFIT SHARING RETIREMENT PLAN, PINCHOS RUBINSON, AKIVA LEIMAN, ESTATE OF BORUCH RUBINSON, CHAIM LEKOWITZ, RACHEL LEKOWITZ, NAFTALI LIPSHUTZ, SARAH LIPSHUTZ, MENDEL LIPSHUTZ, FEIGY LIPSHUTZ, REISEL BERGSTEIN, MICHAEL KONIG, ESTHER WERTENTEIL, MARK WERTENTEIL, MORRIS FRIEDMAN, SARAH FRIEDMAN, AARON WERTENTEIL, TEENA WERTENTEIL, THE REGAL TRADE, S.A., VAVEL CORP., CHADWICK FUNDING CO. L.P., ALLEN SAUSEN, LEONARD SAUSEN D/B/A ATASSCO, KEREN HACHESED OF MONSEY, INC., GENEVA PROPERTIES, L.L.C., MT. PLEASANT PARTNERS, HERSCEL KULEFSKY, ALBERT DAVID PEARLS & GEMS, INC., DEFINED BENEFIT PENSION PLAN, CHAI PROPERTIES CORP, ARTHUR KURTZ, CRESFIELD ASSOCIATES, INC., WEINREB MANAGEMENT, HOWARD MERMELSTEIN, Plaintiffs-Appellants, -v.-

FLEET BANK, N.A., STERLING NATIONAL BANK AND TRUST COMPANY OF NEW YORK and REPUBLIC NATIONAL BANK OF NEW YORK, Defendants-Appellees.

Docket No. 01-7755

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

318 F.3d 113; 2003 U.S. App. LEXIS 946

May 31, 2002, Argued

January 22, 2003, Decided

As Corrected February 12, 2003.

As Amended April 16, 2003.

COUNSEL:

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JUDGES:

Before: STRAUB and SOTOMAYOR, Circuit Judges, and GOLDBERG,* Judge.

OPINION BY:

SOTOMAYOR SOTOMAYOR

OPINION:

SOTOMAYOR, *Circuit Judge*:

The creative pleading in the instant cases serves as a reminder why the Racketeer Influenced and Corrupt Organizations Act's ("RICO") treble damages provisions are not available to remedy every possible injury that can, with some ingenuity, be attributed to a defendant's injurious conduct. Plaintiffs appeal from a judgment of the United States District Court for the Eastern District of New York (Block, J.) dismissing two companion actions, *Lerner v. Fleet Bank, N.A.*, No. 98 CV 7778 ("*Lerner*"), and *Bayroff v. Fleet Bank, N.A.*, No. 98 CV 7779 ("*Bayroff*"), for lack of subject matter jurisdiction. *See Lerner v. Fleet Bank, N.A.*, 146 F. Supp. 2d 224, 226 (E.D.N.Y. 2001). Plaintiffs, investors who were defrauded of millions of dollars held in escrow accounts by an unscrupulous attorney, allege that the banks in which those funds were deposited are liable for their losses. Plaintiffs principally allege that the defendant banks fraudulently concealed the attorney's criminal behavior from state disciplinary authorities and thereby prevented the attorney from being

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* The Honorable Richard W. Goldberg, of the United States Court of International Trade, sitting by designation.

disbarred. Had the attorney been disbarred, plaintiffs claim, they would have refused to make further investments with him and their losses would have been averted. The district court concluded that plaintiffs lacked standing to pursue their civil RICO claims under 18 U.S.C. § 1962 and declined to exercise supplemental jurisdiction over plaintiffs' state-law claims. *See id.* at 232.

We hold that lack of RICO standing does not divest the district court of jurisdiction over the action, because RICO standing, unlike other standing doctrines, is sufficiently intertwined with the merits of the RICO claim that such a rule would turn the underlying merits questions into jurisdictional issues. Thus, we affirm the district court's dismissal of plaintiffs' civil RICO claims because the alleged pattern of racketeering activity was not the proximate cause of plaintiffs' injuries; however, we do so not under Fed. R. Civ. P. 12(b)(1), for lack of jurisdiction, as the district court did, but rather under Fed. R. Civ. P. 12(b)(6), for failure to state a claim. Dismissal of the state-law claims in *Lerner* was improper, however, because federal jurisdiction in that action was also premised on diversity. 28 U.S.C. § 1332(a)(1). Finally, we find that the district court may, in its discretion, exercise supplemental jurisdiction over the state-law claims in *Bayroff* because RICO standing is not a jurisdictional prerequisite the absence of which would divest the district court of the original jurisdiction required to support supplemental jurisdiction. We remand the state-law claims in *Bayroff* for the district court to determine whether exercising supplemental jurisdiction over these claims is appropriate.

BACKGROUND

In reviewing the district court's dismissal under either Fed. R. Civ. P. 12(b)(6) or 12(b)(1), we accept the following factual allegations contained in plaintiffs' complaints as true and draw all reasonable inferences in favor of plaintiffs. *See Conley v. Gibson,* 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957) (Fed. R. Civ. P. 12(b)(6)); *McGinty v. State of New York,* 193 F.3d 64, 68 (2d Cir. 1999) (Fed. R. Civ. P. 12(b)(1)). Plaintiffs in these companion actions are victims of a fraudulent investment scheme engineered by then-attorney David Schick. Schick convinced investors that he had devised a no-risk scheme for generating a high return on their investments. Schick would bid on distressed mortgage pools at auctions by the Resolution Trust Company, the Federal Deposit Insurance Company ("FDIC"), and other banking institutions. Upon being awarded the bid, he would immediately try to re-sell the mortgage pool to another buyer for a quick profit. The acceptance of his bid was subject to a ninety-day due diligence period, so Schick assured his investors that if he was unable to find a buyer within the ninety-day time period, he would be able to rescind his original purchase without incurring any penalty. Schick's plan was apparently foolproof – except, he explained to the investors, in order to make this scheme work, Schick had to prove to the FDIC that he could complete the purchase. He would therefore be required to deposit substantial sums of cash as evidence of his good faith. This is where Schick's potential investors came in.

To convince wary investors that their money would be secure, Schick agreed to deposit the entrusted funds in escrow accounts covered by restrictive provisions. *Lerner v. Fleet Bank, N.A.,* 146 F. Supp. 2d 224, 225-27

(E.D.N.Y. 2001). He also entered into escrow agreements with the investors that stated: "Escrow Agent are attorneys [*sic*] admitted to practice in the State of New York and shall act as fiduciary in accordance with the relevant provisions of the Judiciary Law and all other ethical or legal standards for attorneys admitted to practice in the State of New York and expressly agrees that the only person who shall be entitled to, or have any right or interest in the Escrow Deposit shall be the Depositor." Armed with these guarantees, and relying on the fact that Schick was an attorney in good standing with the New York bar, the investors turned their money over to Schick for deposit in the defendant banks. Ultimately, however, these escrow agreements provided little protection against Schick's unscrupulous conduct. Before the investors discovered his fraud, Schick had raided the accounts repeatedly and managed to steal approximately $82 million.[1]

Some of these defrauded investors pursued a federal RICO action against Fleet Bank, alleging that Fleet Bank had aided Schick in stealing their money by approving withdrawals that violated restrictive provisions on the accounts; failing to inform state banking authorities or investors of the fraud; misleading investors regarding their accounts; approving overdrafts on these accounts; and submitting to investors a fraudulent report overstating the balances of the main escrow accounts. *Schmidt v. Fleet Bank,* 16 F. Supp. 2d 340, 344-45 (S.D.N.Y. 1998).

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[1] Schick eventually pled guilty to fraud in the Southern and Eastern Districts of New York. *See Schmidt v. Fleet Bank,* 16 F. Supp. 2d 340, 344 (S.D.N.Y. 1998).

The district court dismissed these claims both for failure to plead an enterprise adequately and for failure to plead that Fleet had directed the affairs of an enterprise. *Id.* at 346-51.

Constrained by this prior dismissal, plaintiffs in the instant RICO actions proceed under a more creative theory of liability. During the three-year period in which Schick operated his scheme, Schick drew over 500 checks from investor accounts at times when there were insufficient funds to cover the checks.[2] Defendants extended Schick approximately $125 million in overdrafts. After a time, they began to dishonor his checks. These dishonored checks lie at the heart of this action.

Under New York's Disciplinary Code, "[a] lawyer who is in possession of funds belonging to another person incident to the lawyer's practice of law, shall maintain such funds in a banking institution within the State of New York which agrees to provide dishonored check reports" to the Lawyer's Fund for Client Protection of the State of New York ("Lawyer's Fund"). 22 N.Y.C.R.R. § 1200.46(b)(1). Lawyers are required to designate accounts holding their clients' funds "as an 'Attorney Special Account,' or 'Attorney Trust Account,' or 'Attorney Escrow Account,' and shall obtain checks and deposit slips that bear such title." *Id.* § 1200.46(b)(2). While Schick deposited some of the investors' money into properly designated

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[2] It is unclear from the complaints whether these bounced checks were related to Schick's fraudulent schemes, or if they constituted separate misconduct on his part.

accounts, the majority of these accounts were either labeled "attorney at law" or had no special designation.

Plaintiffs nonetheless allege that at the time of the events in question, each of the defendant banks had entered into reporting agreements with the Lawyer's Fund, as provided for by 22 N.Y.C.R.R. § 1300. Moreover, each defendant knew that Schick used these accounts to maintain funds belonging to others incident to his practice of law.

Plaintiffs claim that defendants are part of an enterprise plaintiffs term the "New York State Attorney Disciplinary System." This association-in-fact enterprise purportedly also consists of the Appellate Division of the Supreme Court of the State of New York ("Appellate Division"), the Departmental Disciplinary Committee ("DDC") or the Departmental Grievance Committee ("DGC") of each judicial department with jurisdiction over Schick, and the Lawyer's Fund. The alleged purpose of this enterprise is to enforce New York's attorney disciplinary regulations with respect to an attorney's handling of client funds. According to plaintiffs, defendant banks play a "gate-keeper" role by reporting dishonored checks to the Lawyer's Fund. When the Lawyer's Fund receives a dishonored check report, it forwards the report to the DDC or DGC. In appropriate cases, the DDC or DGC applies to the Appellate Division for the immediate temporary suspension of the attorney, and possibly for disbarment.

Plaintiffs allege that defendants set out to corrupt this enterprise by avoiding the reporting requirements. The complaints assert that the banks feared that if Schick were disciplined or disbarred, he would default on the millions of dollars he owed them, they would lose his

future business, and they might potentially be subject to claims by defrauded investors. To avoid this worst-case scenario, defendants purportedly chose not to submit dishonored-check reports to the Lawyer's Fund. Plaintiffs further allege that defendants committed several predicate acts of mail and wire fraud in furtherance of this scheme by: stamping dishonored checks "refer to maker" rather than "insufficient funds" and returning those bounced checks to the payees, including plaintiffs, through the mail; mailing bank statements to Schick that neglected to mention the dishonored checks; and reassuring some of those notified of the dishonored checks that the checks had been dishonored because of a computer glitch or because the check had been written on the wrong account. Plaintiffs also allege that defendants transported stolen merchandise, although it is unclear from the complaint how this predicate offense was in furtherance of defendants' alleged scheme against the Lawyer's Fund.

Plaintiffs' theory of causation is equally novel. Plaintiffs claim that, by failing to report the bounced checks to the Lawyer's Fund as required by New York regulations, defendants prevented the New York State Attorney Discipline System from taking action against Schick. Had the Lawyer's Fund been informed that Schick was improperly overdrawing funds from his clients' escrow accounts, the Appellate Division would have immediately suspended or disbarred him from the practice of law; this would have led plaintiffs, the investors, to distrust Schick and discontinue their investments, thus sparing millions of dollars in losses.

Defrauded investors bring these two companion suits, *Lerner* and *Bayroff,* against defendants, alleging violations of 18 U.S.C. § 1962(c)-(d) and various state-law claims.

These actions are identical in substance. Plaintiffs in the *Bayroff* action are citizens of New York, however, while plaintiffs in the *Lerner* action are citizens of Delaware, California, and nine foreign countries who brought their suit as a diversity action.

Defendants moved to dismiss the RICO claims in both complaints, alleging that plaintiffs had failed to plead, *inter alia,* the mail and wire fraud predicate acts with the requisite particularity, a RICO enterprise, or a pattern of racketeering activity. Defendants also argued that plaintiffs lacked standing to bring a RICO action. The district court consolidated the actions for purposes of resolving defendants' motions. *Lerner,* 146 F. Supp. 2d at 225 n.1. The district court then dismissed the actions for lack of subject matter jurisdiction pursuant to Fed. R. Civ. P. 12(b)(1), applying a zone-of-interests analysis. *Id.* at 231-32. The district court held that plaintiffs do not fall within the class of persons that the reporting requirements were intended to benefit. *See id.; see also Holmes v. Sec. Investor Prot. Corp.,* 503 U.S. 258, 287-88, 117 L. Ed. 2d 532, 112 S. Ct. 1311 (1992) (Scalia, J., concurring) (discussing the applicability of the zone-of-interests analysis in determining standing under RICO). The district court declined to exercise supplemental jurisdiction over the state-law claims in both complaints, and dismissed the two actions in their entirety. *Lerner,* 146 F. Supp. 2d 224 at 228. This consolidated appeal followed.

DISCUSSION

The district court dismissed plaintiffs' RICO claims pursuant to Fed. R. Civ. P. 12(b)(1) for lack of statutory standing. We affirm this dismissal under Fed. R. Civ. P.

12(b)(6) for failure to state a claim upon which relief may be granted. Under both provisions, we review the district court's dismissal *de novo*. *See Conley,* 355 U.S. at 45-46, *McGinty,* 193 F.3d at 68.

I. RICO Standing

The RICO statute grants standing to "[a]ny person injured in his business or property by reason of a violation of section 1962. . . . " 18 U.S.C. § 1964(c). To demonstrate standing, a plaintiff must plead, at a minimum, "(1) the defendant's violation of § 1962, (2) an injury to the plaintiff's business or property, and (3) causation of the injury by the defendant's violation." *Commercial Cleaning Servs., L.L.C. v. Colin Serv. Sys., Inc.,* 271 F.3d 374, 380 (2d Cir. 2001). This third requirement is satisfied if the defendant's injurious conduct is both the factual and the proximate cause of the injury alleged. *Holmes,* 503 U.S. at 268.

We have previously implied that there might be an additional standing component – that the plaintiff must fall within the zone of interests RICO seeks to protect. *See Laborers Local 17 Health & Benefit Fund v. Philip Morris, Inc.,* 191 F.3d 229, 236 (2d Cir. 1999). "[T]he zone of interests test . . . is an inquiry 'into whether . . . the plaintiff is within the class of persons sought to be benefited by the provision at issue.'" *Id.* (quoting *Holmes,* 503 U.S. at 287 (Scalia, J., concurring)).

While the zone-of-interests test may indeed be relevant to determining statutory standing, it is unclear precisely how this test would apply under the complex structure of the RICO statute. A RICO violation encompasses not only a violation of § 1962, but also violations of

the underlying statutes that constitute the array of predicate acts. In addition, in this case, plaintiff's RICO violation also encompasses the alleged corruption of New York's regulatory system for disciplining lawyers. The district court relied upon its determination that plaintiffs did not fall within the zone of interests of the reporting regulations for this system in dismissing plaintiffs' RICO claim for lack of standing. *Lerner,* 146 F.Supp.2d at 231. Whether a plaintiff must fall within the zone of interests of both RICO and the underlying statutes and regulations in order to pursue a RICO action is a question we have not yet answered.

Both the Supreme Court in *Holmes* and this Circuit in *Powers v. British Vita, P.L.C.,* 57 F.3d 176, 188 (2d Cir. 1995), have been squarely confronted with the issue, and both courts have found it wiser to resolve those cases on grounds of proximate causality. In *Holmes,* the Supreme Court granted certiorari to consider whether "a party which was neither a purchaser nor a seller of securities, and for that reason lacked standing to sue under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, is free of that limitation on standing when presenting essentially the same claims under the [RICO] Act." *Holmes,* 503 U.S. at 265 n.7. The Court had previously held that standing to bring a private cause of action under § 10(b) was confined to buyers and sellers of the security. *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 44 L. Ed. 2d 539, 95 S. Ct. 1917 (1975). The *Holmes* majority declined to resolve the standing issue that had split the circuits, however, as it found that plaintiffs had not suffered a direct injury and thus could not satisfy the causation element of RICO standing. *Holmes,* 503 U.S. at 275-76 ("A review of the conflicting cases shows that all

could have been resolved on proximate-causation grounds, and that none involved litigants like those in *Blue Chip Stamps v. Manor Drug Stores,* persons who had decided to forgo securities transactions in reliance on misrepresentations. Thus, we think it inopportune to resolve the issue today." (internal citation omitted)).[3]

Four concurring Justices wrote separately to express their views on the question on which certiorari had been granted. Justice O'Connor, joined by Justices White and Stevens, reasoned that standing under § 1964(c) focuses only on the "injury" of any person, not on the legal right of such plaintiff to sue for violations of the predicate acts. *Id.* at 280 (O'Connor, J., concurring). Justice O'Connor therefore concluded that RICO does not incorporate the standing requirements of the predicate acts alleged. *Id.*

Justice Scalia also concurred in the result reached by the majority, but rejected the positions taken by Justice O'Connor and the majority regarding the RICO standing requirement. Justice Scalia instead argued that, for a plaintiff to have standing to pursue a RICO action, he or she must satisfy the traditional elements of statutory standing of the predicate statutes, thereby demonstrating the proper nexus between the injuries alleged and the predicate acts. *Id.* at 288-89 (Scalia, J., concurring). These

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[3] In holding that a plaintiff did not have standing to pursue a RICO action unless his or her injuries were proximately caused by the violation of the RICO statute, the Court relied upon the fact that the explicit statutory language echoed the language of the Sherman Act, which federal courts had read as incorporating common-law principles of proximate causation. *Holmes,* 503 U.S. at 267.

requirements include proximate causation[4] and the zone-of-interests test. Justice Scalia argued that § 1964(c) of the RICO statute did not extend the zone-of-interests protected by the underlying statutes, allowing plaintiffs to recover under RICO for a class of harms that was not encompassed within the underlying statute.[5] *Id.* at 288.

In *Powers,* this Court was similarly confronted with the question whether a plaintiff must satisfy the standing requirements of § 10(b) in order to bring a RICO claim predicated on violations of that provision. *Powers,* 57 F.3d at 188. After surveying the conflicting positions taken on this standing issue in the concurring opinions in *Holmes,* we decided to follow the Supreme Court's lead and, refraining from entering the fray, resolved the standing issue on the grounds of proximate causation. *Id.; cf. Abrahams v. Young & Rubicam, Inc.,* 79 F.3d 234, 238 (2d Cir. 1996).[6]

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[4] Justice Scalia therefore rejected the majority's position that the proximate causality requirement under RICO is derived from the statute's express language. *Holmes,* 503 U.S. at 287.

[5] Neither Justice O'Connor nor Justice Scalia discussed the particular zone-of-interests test that the district court focused upon, that is, the zone of interests of the reporting regulations that were a part of the underlying regulatory system allegedly corrupted; the Justices focused instead on the potential application of a zone-of-interests test for the underlying predicate acts that constituted a RICO violation.

[6] In *Abrahams,* we used the language of zone-of-interests, rather than proximate cause, to discuss standing requirements under the RICO statute. *Abrahams,* 79 F.3d at 237 (reframing the standing inquiry to focus on whether the plaintiff was in the category the statute intended to protect, and whether the harm that occurred was the mischief the statute sought to avoid). Yet in so doing, we were not importing an additional standing requirement; we merely sought to

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Although we are troubled by the issues potentially raised by the application of the zone-of-interests test to determine standing in the RICO context, we need not delve deeply into the implications in the present case. We believe the better approach is that adopted by the Supreme Court in *Holmes* and this Court in *Powers*: if the standing issue may be resolved on proximate cause grounds, the question whether the plaintiff must also satisfy the standing requirements of the underlying statutes whose violations constitute predicate acts (the question that was addressed by the concurrences in *Holmes*) or the underlying regulatory system allegedly corrupted (the question that was addressed by the district court) need not be reached.[7] As plaintiffs cannot show that defendants' alleged violations of § 1962 proximately caused

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apply the same standing test endorsed by the *Holmes* Court under a more precise terminology. *Id.* at 237 n.3. Our fear was that use of the proximate cause language in discussions of statutory standing could lead to confusion with its common-law counterpart. *Id.* As *Abrahams* recognized, however, RICO proximate causation is a distinct concept – one that sometimes overlaps with zone-of-interests analysis. Both of these statutory standing principles are grounded on similar policy considerations, imposing limitations on the types of injuries that are sufficiently related to core RICO concerns as to be cognizable. Thus, the reasonably foreseeable victim of a RICO enterprise will often be, unsurprisingly, the type of victim the RICO statute seeks to protect. Indeed, Justice Scalia has implied that proximate causality, as used in the statutory context, may simply be an element of the zone-of-interests test. *Holmes,* 503 U.S. at 287 n.* (Scalia, J., concurring). In subsequent cases, we have deemed it prudent to revert to the proximate cause terminology employed in *Holmes* when speaking of this same causation principle. *See Laborers Local 17,* 191 F.3d at 234 n.3. Here, we limit our discussion to proximate causation.

[7] We encourage district courts to follow this approach in future opinions addressing RICO standing issues.

their injuries, they lack standing to pursue their RICO claims.[8]

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[8] Plaintiffs have, however, alleged an injury "fairly traceable" to defendants' conduct, and therefore meet the lesser burden for constitutional standing. *See Ctr. for Reprod. Law & Policy v. Bush*, 304 F.3d 183, 191-92 (2d Cir. 2002). Specifically, plaintiffs allege that their injuries were fairly traceable to defendants' conduct because had defendants met their reporting requirements Schick would have been disbarred promptly, and plaintiffs would have ceased investing in Schick's scheme. Thus, plaintiffs' complaint is founded upon the allegation that the New York reporting requirements applied to the bank accounts Schick used.

Defendants point out that an attorney's duty to keep funds in segregated escrow accounts applies only to "[a] lawyer who is in possession of funds belonging to another person *incident to the lawyer's practice of law*. . . . " *See* 22 N.Y.C.R.R. § 1200.46(b)(1) (emphasis added); *see also id.* § 7200.8(d) (exempting "losses arising from financial transactions with attorneys that do not occur within an attorney-client relationship and the practice of law" from the list of injuries that the Lawyer's Fund will reimburse). As the reporting requirements only apply to such accounts, defendants assert that they had no duty to report any irregularities and therefore cannot be liable for failure to do so. *See* 22 N.Y.C.R.R. § 1300.1(c) ("A dishonored check report by a banking institution shall be required whenever a properly payable instrument is presented against an attorney special, trust or escrow account which contains insufficient available funds, and the banking institution dishonors the instrument for that reason.") Although plaintiffs are not so specific as to allege that they contacted Schick for the purpose of obtaining legal advice or that Schick provided them with legal advice, the complaint refers to the investors as Schick's "clients." In addition, while the majority of these accounts were not designated as escrow or trust accounts, plaintiffs allege that defendants knew that at least some of these accounts were subject to the reporting requirements, but willfully ignored these requirements.

Finally, plaintiffs allege that the fraud was so substantial that defendants' report of the overdrafts and other irregularities "would have resulted in Schick's immediate suspension and/or disbarment" before plaintiffs made further investments or the funds were misappropriated. While sufficiently tenuous to fail to demonstrate

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Plaintiffs have not demonstrated that their injury was proximately caused "by a pattern of racketeering activity violating section 1962 or by individual RICO predicate acts." *Hecht v. Commerce Clearing House, Inc.*, 897 F.2d 21, 23 (2d Cir. 1990); *see also Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 497, 87 L. Ed. 2d 346, 105 S. Ct. 3275 (1985) ("[T]he compensable injury necessarily is the harm caused by predicate acts sufficiently related to constitute a pattern, for the essence of the violation is the commission of those acts in connection with the conduct of an enterprise. . . . Any recoverable damages occurring by reason of a violation of § 1962(c) will flow from the commission of the predicate acts."); *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 769 (2d Cir. 1994) ("RICO provides a civil remedy only to those persons injured 'by reason of' the defendant's predicate acts."). First, plaintiffs principally contend that their injuries were caused by defendants' violations of state reporting requirements. At worst, this offense qualifies as a breach of defendants' agreements with the Lawyer's Fund; it certainly does not qualify as a RICO predicate act under § 1961(1). Any injury caused by the failure to abide by the reporting agreements cannot form the basis for RICO standing.

Second, to the extent that plaintiffs' complaint can be read to allege that defendants engaged in a pattern of racketeering activity that led to the concealment of

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proximate causation, we cannot say, taking the facts alleged in the complaint as true, that plaintiffs do not allege an injury fairly traceable to defendants' conduct.

Schick's improper conduct from the Lawyer's Fund,[9] the connection between the RICO violation and the injury alleged is too attenuated to satisfy the proximate cause requirement. The RICO statute requires that the pattern of racketeering activity or the individual predicate acts impose a direct injury on plaintiffs.[10] *See Laborers Local 17,* 191 F.3d at 240. "Central to the notion of proximate cause [under RICO] is the idea that a person is not liable to all those who may have been injured by his conduct, but only to those with respect to whom his acts were 'a substantial factor in the sequence of responsible causation,' and whose injury was 'reasonably foreseeable or anticipated as a natural consequence.'" *First Nationwide Bank,* 27 F.3d at 769 (quoting *Hecht,* 897 F.2d at 23-24); *see also Laborers Local 17,* 191 F.3d at 235-36. The racketeering activities alleged are not a substantial factor in the chain of causation that led to plaintiffs' losses. Nor were those

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[9] This strained reading of the complaint presents its own problems, as plaintiffs have provided scant detail regarding the nature of these predicate acts of mail and wire fraud, and many of the predicate acts that have been described appear to bear no relation to the defendants' scheme to conceal Schick's bounced checks from the Lawyer's Fund.

[10] RICO derives its proximate cause requirement from the following statutory language: "Any person injured in his business or property *by reason of* a violation of section 1962 of this chapter may sue. . . ." 18 U.S.C. § 1964(c) (emphasis added). Because Congress modeled RICO's causation language on identical language in § 4 of the Clayton Act, 15 U.S.C. § 15, the courts have interpreted RICO's proximate causation requirement with reference to prior judicial interpretation of the Clayton Act's proximate causation requirement. *See Holmes,* 503 U.S. at 267; *Cf. Moore v. Paine Webber,* 189 F.3d 165, 178 (2d Cir. 1999) (Calabresi, J., concurring) (noting that "the pertinent requirements of proximate cause in a RICO case are those intended by legislature that passed the statute").

losses a reasonably foreseeable consequence of that conduct.

"The mere recitation of the chain of causation alleged by the plaintiffs is perhaps the best explanation of why they do not have standing in this case." *Newton v. Tyson Foods, Inc.*, 207 F.3d 444, 447 (8th Cir. 2000). In order to demonstrate some link between the RICO violations alleged and the loss of their investments, plaintiffs must show that, if the defendant banks had not committed the predicate acts of mail and wire fraud, (1) unspecified third parties would have become aware that there were insufficient funds in the escrow accounts to cover Schick's checks; (2) the Lawyer's Fund, in some fashion, would then have become aware of these bounced checks; (3) the DDC or DGC, upon receiving the report of dishonored checks from the Lawyer's Fund, would have recommended to the Appellate Division that Schick be suspended or disbarred; (4) the Appellate Division would have investigated Schick and adopted this recommendation almost "immediately" after Schick bounced these checks; and (5) plaintiffs would have been made aware of Schick's removal from the practice of law in time to halt further investments. Simply put, plaintiffs' chain of causation makes clear that they were not directly injured by defendants' alleged racketeering activity; we cannot say that such a circuitous route, relying on the independent action of various third parties, imposes a direct injury on plaintiffs. Each of the assumptions upon which this theory rests is inherently speculative. *See id.* ("The alleged injuries . . . are far distant along the chain of causation from [defendants'] alleged wrongs and are too attenuated and removed from those wrongs to provide a basis for standing under RICO."). For example, it would be impossible to determine if and when the

Appellate Division would have disciplined Schick. Thus, there is no rational way to allocate the damages that flow from the failure of the Appellate Division to act. *Cf. Laborers Local 17,* 191 F.3d at 239-40 (holding that a health plan's suit against tobacco companies for their actions against plan participants was not sufficiently direct to support RICO standing because the damages claims would be incredibly speculative and dependent on unpredictable intervening events such as the agency of individual smokers).

Moreover, we have repeatedly emphasized that the reasonably foreseeable victims of a RICO violation are typically limited to the targets, competitors and intended victims of the racketeering enterprise. *In re Am. Express Co. S'holder Litig.,* 39 F.3d 395, 400 (2d Cir. 1994) (holding that injury to American Express shareholders was not the foreseeable result of a scheme to discredit an American Express competitor); *Hecht,* 897 F.2d at 24 (holding that the loss of employment for failure to cooperate in RICO scheme was not proximately caused by racketeering activity because the employee was not "the target of the racketeering enterprise"); *Sperber v. Boesky,* 849 F.2d 60, 64 (2d Cir. 1988) (holding that plaintiffs were not injured by defendant's racketeering activities with regard to companies whose stock the plaintiffs did not own, because any artificial increase in the price of stocks plaintiffs owned was too remote from defendant's illegal activities to satisfy the proximate causation requirement.).

Plaintiffs in the instant case are too far removed from the actual predicate acts committed to recover for any injuries that they suffered. The fundamental flaw in plaintiffs' theory is plaintiffs' allegation that defendants proceeded independently of Schick, without the purpose or

design of aiding in his fraud against plaintiffs. Defendants' goal was to "perpetrate a fraud on the attorney disciplinary system." *Lerner* Compl. at ¶ 122. That alleged fraud, however, is not tied to plaintiffs' injuries from Schick's fraud. Accepting plaintiffs' allegation would mean that the Lawyer's Fund, not plaintiffs, was the target of defendants' alleged racketeering enterprise. Plaintiffs' harm is therefore an unintended and unanticipated byproduct of the banks' alleged racketeering activities.

II. Diversity Jurisdiction

The district court declined to exercise jurisdiction over the state-law claims contained in the *Lerner* complaint, although diversity jurisdiction exists in the *Lerner* action because plaintiffs' citizenship is diverse from defendants' and the amount in controversy is more than $75,000. *See* 28 U.S.C. § 1332(a). On appeal, defendants contend that this dismissal was not in error because the plaintiffs improperly and deliberately manufactured jurisdiction by dividing the diverse plaintiffs and the non-diverse plaintiffs into two separate actions. Plaintiffs' "manipulation" is not, however, of the type that defeats diversity jurisdiction.

We know of no rule of law that requires plaintiffs to align with all other similarly injured plaintiffs before they may bring suit.[11] Nor are we aware of any principle that prevents an injured party from choosing among potential

[11] There is no allegation in the present case that any of the *Bayroff* plaintiffs are indispensable parties to the *Lerner* action and that their joinder was therefore required. *See* Fed. R. Civ. P. 19(b).

co-plaintiffs based on diversity concerns. Had the *Lerner* plaintiffs brought their suit independently of the *Bayroff* plaintiffs, defendants could not argue that we lacked federal jurisdiction over the *Lerner* action because those plaintiffs refused to allow New York citizens to join their suit. Defendants' argument therefore amounts to a claim that the filing of the *Bayroff* complaint in tandem with the *Lerner* complaint somehow divests the federal courts of jurisdiction. This clearly is not the case.

In determining whether the parties have improperly manufactured federal jurisdiction, the essential inquiry is whether "there is a *bona fide* controversy between . . . citizens of different states." *Md. Cas. Co. v. W.R. Grace & Co.*, 23 F.3d 617, 623 (2d Cir. 1993). Selecting parties to a lawsuit based upon citizenship does not implicate this concern in the same manner as the misalignment of parties, *see City of Dawson v. Columbia Ave. Sav. Fund, Safe Deposit, Title & Trust Co.*, 197 U.S. 178, 49 L. Ed. 713, 25 S. Ct. 420 (1905), the failure to name an indispensable party, *see Envirotech Corp. v. Bethlehem Steel Corp.*, 729 F.2d 70, 76 (2d Cir. 1984), or the collusive assignment of claims, *see* 28 U.S.C. § 1359 ("A district court shall not have jurisdiction of a civil action in which any party, by assignment or otherwise, has been improperly or collusively made or joined to invoke the jurisdiction of such court."). These practices are prohibited because the parties, through manipulation, have funneled what are essentially local disputes between non-diverse parties into the federal courts. *See, e.g., Airlines Reporting Corp. v. S & N Travel, Inc.*, 58 F.3d 857, 861-62 (2d Cir. 1995). The *Lerner* plaintiffs are genuinely diverse from, and have a genuine dispute with, these defendants. Their choice to band together as diverse plaintiffs injured by defendants

is, therefore, not an improper attempt to manufacture federal jurisdiction.

III. Supplemental Jurisdiction

Plaintiffs argue that the district court should have exercised supplemental jurisdiction over the *Bayroff* state-law claims because they are so closely related to the *Lerner* claims that trying the two sets of claims together is judicially economical.

A district court may exercise supplemental jurisdiction over state-law claims "in any civil action of which the district courts have original jurisdiction," as long as the state-law claims "are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution." 28 U.S.C. § 1367(a). The *Bayroff* plaintiffs' state-law claims clearly fall within the same case or controversy as their RICO claim; thus, the second portion of the test is easily met in this case. The more difficult question is whether the *Bayroff* plaintiffs' lack of RICO standing implies a jurisdictional bar to their RICO claims. If so, the district court did not have "original jurisdiction" over the action because the RICO claim was the only federal claim and, for the *Bayroff* plaintiffs, the only basis for subject matter jurisdiction. *See* 28 U.S.C. § 1331 ("The district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States.").

Because the requirements set forth in § 1964(c), including that a plaintiff's injury be proximately caused by defendants' conduct, are often termed "RICO standing,"

courts sometimes discuss them as jurisdictional requirements, akin to constitutional standing. *See, e.g., Moore v. PaineWebber, Inc.,* 189 F.3d 165, 169 n.3 (2d Cir. 1999). *But see Rent Stabilization Ass'n v. Dinkins,* 5 F.3d 591, 594 & n.2 (2d Cir. 1993) (stating that "dismissals for lack of standing may be made pursuant to Fed. R. Civ. P. 12(b)(6), rather than [as a defect in federal jurisdiction pursuant to] Fed. R. Civ. P 12(b)(1)" and clarifying that "standing and *subject matter* jurisdiction are separate questions"). Indeed, both statutory standing under RICO and constitutional standing concern whether the plaintiff at issue is the appropriate plaintiff to bring a claim. *See Sedima,* 473 U.S. at 496 (holding that a plaintiff "only has standing [under RICO] if . . . *he* has been injured in *his* business or property by the conduct constituting the violation" (emphasis added)); *Lujan v. Defenders of Wildlife,* 504 U.S. 555, 563, 119 L. Ed. 2d 351, 112 S. Ct. 2130 (1992) ("The 'injury in fact' test [for constitutional standing] . . . requires that the party seeking review be himself among the injured." (quoting *Sierra Club v. Morton,* 405 U.S. 727, 734, 31 L. Ed. 2d 636, 92 S. Ct. 1361 (1972))). Because RICO standing is not a constitutional prerequisite to jurisdiction and the determination that proximate causation is lacking is sufficiently intertwined with the merits of the RICO claim, however, we find that dismissal for failure to plead proximate causation between the alleged RICO violation and plaintiffs' injuries does not divest the district court of original jurisdiction and, therefore, the exercise of supplemental jurisdiction would be permissible pursuant to 28 U.S.C. § 1367(a).

Standing generally has two aspects: constitutional standing, a mandate of the "case or controversy" requirement in Article III, and prudential considerations of

standing, which involve "judicially self-imposed limits on the exercise of federal jurisdiction. . . ." *Allen v. Wright,* 468 U.S. 737, 751, 82 L. Ed. 2d 556, 104 S. Ct. 3315 (1984). Prudential considerations include "the general prohibition on a litigant's raising another person's legal rights, the rule barring adjudication of generalized grievances more appropriately addressed in the representative branches, and the requirement that a plaintiff's complaint fall within the zone of interests protected by the law invoked." *Id.* Finally, a related aspect of standing, statutory standing, is broadly described as a part of the prudential considerations regarding the proper limits of jurisdiction.[12] *See id.; Law Offices of Curtis V. Trinko, L.L.P. v. Bell Atl. Corp.,* 305 F.3d 89, 97 (2d Cir. 2002).

It is clear that constitutional standing is a jurisdictional prerequisite to suit. *See Steel Co. v. Citizens for a Better Env't,* 523 U.S. 83, 101, 140 L. Ed. 2d 210, 118 S. Ct. 1003 (1998) ("While some . . . cases must be acknowledged to have diluted the absolute purity of the rule that Article III jurisdiction is always an antecedent question, none of them even approaches approval of a doctrine of hypothetical jurisdiction that enables a court to resolve contested questions of law when its jurisdiction is in doubt."). Issues relating to the merits of an action, almost by definition, are not jurisdictional. *See id.* at 89. Although prudential

[12] Some courts find statutory standing to be a separate, third aspect of standing. *See, e.g., Libertad v. Welch,* 53 F.3d 428, 436 (1st Cir. 1995) (discussing constitutional considerations, prudential considerations, and statutory RICO standing in turn). Our analysis does not depend on whether statutory standing is a separate aspect of standing or a part of the prudential aspect of standing; we therefore decline to address the issue at this time.

considerations of standing are also generally treated as jurisdictional in nature, *see, e.g., Thompson v. County of Franklin,* 15 F.3d 245, 248 (2d Cir. 1994), the applicability of this rule to RICO's statutory proximate cause requirement is less clear.[13]

In *Steel Co.,* the Supreme Court noted that courts may determine whether a cause of action exists under a given statute, an issue of statutory construction that goes to the merits of the action, before addressing the zone-of-interests prudential dimension of standing, an issue the Court labeled as statutory standing. *See id.* at 97; *see also Nat'l R.R. Passenger Corp. v. Nat'l Ass'n of R.R. Passengers,* 414 U.S. 453, 465 n.13, 38 L. Ed. 2d 646, 94 S. Ct. 690 (1974) (deciding whether a statutory cause of action existed before determining whether the plaintiff met the statutory standing requirements). As the Supreme Court explained:

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[13] Although the *Holmes* Court derived its interpretation of the proximate cause requirement from the language of § 1964(c), *Holmes v. Sec. Investor Protection Corp.,* 503 U.S. 258, 268, 117 L. Ed. 2d 532, 112 S. Ct. 1311 (1992), it has been suggested that the proximate cause requirement is really part and parcel of our prudential zone-of-interests test. *See id.* at 286-88 (Scalia, J., concurring in the judgment); *Moore v. PaineWebber, Inc.,* 189 F.3d 165, 178-79 (2d Cir. 1999) (Calabresi, J., concurring). While this may be true, we note that civil RICO specifically affords relief to victims of racketeering enterprises, which plaintiffs claim to be; as such, the question whether plaintiffs have sufficiently alleged causation between the alleged RICO violation and their injuries goes to the merits of their particular claim rather than to the more abstract question whether they fall within the statute's zone-of-interests. *See, e.g., Holmes,* 503 U.S. at 287 (Scalia, J., concurring in the judgment) (distinguishing proximate causation from the question whether plaintiff "is within the class of persons sought to be benefitted by the provision at issue").

> The merits inquiry and the statutory standing inquiry often 'overlap.' The question whether *this* plaintiff has a cause of action under the statute, and the question whether *any* plaintiff has a cause of action under the statute are closely connected – indeed, depending upon the asserted basis for lack of statutory standing, they are sometimes identical, so that it would be exceedingly artificial to draw a distinction between the two.

Steel Co., 523 U.S. at 97 n.2 (internal citation omitted). Thus, at least in some circumstances, lack of statutory standing does not divest a district court of jurisdiction to determine the underlying merits of the action. In declining to require statutory standing as a prerequisite to jurisdiction when the merits of whether a cause of action exists are so intertwined with the statutory standing question, the Supreme Court reasoned that if "all cause-of-action questions may be regarded as jurisdictional questions, and thus capable of being decided where there is no genuine case or controversy, it is hard to see what is left of that limitation in Article III." *Id.* at 93.

In determining whether RICO's proximate cause requirement should be treated as jurisdictional, we take a cue from the *Steel Co.* Court's emphasis on the problem of having merits issues become jurisdictional if merits issues are so intertwined with the standing issue that any distinction becomes "exceedingly artificial." *Id.* at 97 n.2. Our decision in *Thompson* is not to the contrary. In *Thompson,* we held that standing, whether in its constitutional or prudential form, was a jurisdictional limitation and as such could not be waived. *Thompson,* 15 F.3d at 248. The question in *Thompson* was whether an individual

plaintiff could maintain an action under the Nonintercourse Act, 25 U.S.C. § 177, which regulates the ownership of Indian tribal land, or whether the only proper plaintiff was the Indian tribe itself. Thus, in *Thompson,* the issue of statutory standing did not implicate the merits of the action, which related to the proper boundaries of the St. Regis reservation; it related solely to the question whether individual members of an Indian tribe could sue under the Nonintercourse Act.

Returning to the particular statutory standing question before us, we note that we have previously suggested in dictum that RICO's causation requirement raises a jurisdictional issue. *Moore,* 189 F.3d at 169 n.3 ("Because loss causation is an element of standing to sue under the RICO statute, the appropriate ground of dismissal for failure to plead loss causation would seem to be the lack of subject matter jurisdiction."); *cf. Seward v. Devine,* 888 F.2d 957, 964 (2d Cir. 1989) ("The exercise of pendant jurisdiction . . . should abide" the district court's finding with respect to RICO standing.). Still, we recognized in *Moore* that we have treated dismissals for lack of RICO standing as dismissals for failure to state a claim pursuant to Fed. R. Civ. P. 12(b)(6), rather than as dismissals for lack of subject-matter jurisdiction pursuant to Fed. R. Civ. P. 12(b)(1). *Moore,* 189 F.3d at 169 n.3; *see, e.g., Burdick v. Am. Express Co.,* 865 F.2d 527, 528 (2d Cir. 1989) (per curiam). As we noted in *Moore,* this distinction rarely has practical consequences, because the standards for dismissal under 12(b)(6) and 12(b)(1) are substantively identical. *Moore,* 189 F.3d at 169 n.3. *But see Thompson,* 15 F.3d at 249 (noting that the party invoking the jurisdiction of the court has the burden of proof in a 12(b)(1)

motion, in contrast to a 12(b)(6) motion, in which the defendant has the burden of proof).

In this case, however, the difference between a jurisdictional bar to bringing a claim and a failure to state a claim under Fed. R. Civ. P. 12(b) is critical, because it determines whether the district court may exercise supplemental jurisdiction over the *Bayroff* state-law claims. To our knowledge, only one Circuit has directly addressed this issue in an analogous situation, holding that statutory standing under the antitrust laws is not a prerequisite to federal subject matter jurisdiction. *See In re Lorazepam & Clorazepate Antitrust Litig.,* 351 U.S. App. D.C. 223, 289 F.3d 98, 107-08 (D.C. Cir. 2002) ("Unlike constitutional standing, this court's jurisdiction does not turn on antitrust standing.").

In *Lorazepam,* the D.C. Circuit relied upon the Supreme Court's differentiation between antitrust standing and constitutional standing in *Associated General Contractors of Cal. v. Cal. State Council of Carpenters,* 459 U.S. 519, 74 L. Ed. 2d 723, 103 S. Ct. 897 (1983). In *Associated General Contractors,* the Supreme Court stated that determining "whether [plaintiff] may recover for the injury it allegedly suffered by reason of the defendants' coercion against certain third parties . . . requires us to evaluate the plaintiff's harm, the alleged wrongdoing by the defendants, and the relationship between them." *Id.* at 535 "The label "antitrust standing" has traditionally been applied to some of the elements of this inquiry. As commentators have observed, the focus of the doctrine of 'antitrust standing' is somewhat different from that of standing as a constitutional doctrine." *Id.* at 535 n.31.

While the *Lorazepam* court does not make its reasoning explicit, it is consistent with the guideline articulated in *Steel Co.* that if statutory standing is essentially indistinguishable from the merits of the action, its absence is not a jurisdictional bar to suit, but a failure to state a claim. As *Associated General Contractors* emphasizes, the proximate causation requirement in antitrust standing requires a court to evaluate the merits of the action. *Associated Gen. Contractors,* 459 U.S. at 535; *see also Ass'n of Data Processing Serv. Orgs., Inc. v. Camp,* 397 U.S. 150, 153, 25 L. Ed. 2d 184, 90 S. Ct. 827 (1970) (distinguishing question whether plaintiff asserted a legal interest that was harmed by agency action from the question of standing; "[the] legal interest test goes to the merits. The question of standing is different. It concerns, apart from the 'case' or 'controversy' test, the question whether the interest sought to be protected by the complainant is arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question.").

Similarly, the requirement that a plaintiff demonstrate proximate causation to have standing under the RICO statute goes to the merits of the action. "Where the plaintiff alleges each element of a [RICO] violation, the compensable injury necessarily is the harm caused by [the] predicate acts. . . ." *Sedima,* 473 U.S. at 497. In evaluating whether a plaintiff has standing under RICO, the court must, as in an antitrust case, "evaluate the plaintiff's harm, the alleged wrongdoing by the defendants, and the relationship between them." *Associated Gen. Contractors,* 459 U.S. at 535. Thus, the issue of proximate causation in the RICO standing context is sufficiently intertwined with the merits of the RICO claim

that any potential distinction between statutory standing as a jurisdictional issue and the merits issue is untenable. It would change the merits issues into limitations on jurisdiction.

By implicitly addressing whether lack of statutory standing under RICO is a jurisdictional bar to suit, other courts reinforce our determination that RICO standing is not a jurisdictional issue. *See, e.g., Maio v. Aetna, Inc.,* 221 F.3d 472, 481-82 n.7 (3d Cir. 2000) (noting that the Third Circuit's practice was to treat RICO and antitrust standing as non-jurisdictional, but declining to decide whether this practice was proper); *DeMauro v. DeMauro,* 115 F.3d 94, 96 (1st Cir. 1997) (stating that whether a plaintiff has pled "a claim of 'injury' to her 'business or property' as required for a civil RICO damages action . . . is sometimes described as a 'standing' issue" and noting that "there is plainly a case or controversy under Article III; but the statutory precondition of injury to business or property must also be met"); *cf. Whalen v. Carter,* 954 F.2d 1087, 1097 (5th Cir. 1992) ("Because we have concluded that [plaintiff] might have the requisite standing to assert his RICO claims, we note that there is at least some possibility [plaintiff] could assert his state law claims under 28 U.S.C. § 1367(a). . . . Neither [plaintiff] nor the defendants have briefed the issue whether the district court can exercise supplemental jurisdiction here.").

In sum, despite describing the proximate causation requirement as "RICO standing," such standing is not jurisdictional in nature under Fed. R. Civ. P. 12(b)(1), but is rather an element of the merits addressed under a Fed. R. Civ. P. 12(b)(6) motion for failure to state a claim. RICO standing is sufficiently intertwined with the merits of the action, such that its determination requires an evaluation

of the merits of the action and makes any potential distinction between the merits and RICO standing exceedingly artificial.

Thus, *Bayroff* plaintiffs' lack of statutory standing does not divest the district court of original jurisdiction over the *Bayroff* action. The district court had original jurisdiction to support the exercise of supplemental jurisdiction over the *Bayroff* plaintiffs' state-law claims.

Having determined that the district court may exercise supplemental jurisdiction over the *Bayroff* state-law claims, we now turn to the prudential aspects of whether the district court should in fact do so. The factors that a district court should consider in making this decision are unchanged by our analysis above. In most circumstances, a district court should decline supplemental jurisdiction if all federal claims have been dismissed at the pleading stage. *See United Mine Workers v. Gibbs,* 383 U.S. 715, 726, 16 L. Ed. 2d 218, 86 S. Ct. 1130 (1966). Because the district court must adjudicate identical issues in *Lerner,* however, judicial economy might best be served by exercising supplemental jurisdiction over the *Bayroff* state-law claims. Because it dismissed both the *Lerner* and *Bayroff* actions, the district court did not consider whether retaining supplemental jurisdiction over the *Bayroff* state-law claims might be appropriate given that it retains jurisdiction over the *Lerner* state-law claims. As this decision is within the district court's discretion, we remand the *Bayroff* action for its determination.

CONCLUSION

For the reasons stated, we affirm the district court's dismissal of plaintiffs' RICO claims for lack of standing, but we do so under Rule 12(b)(6) for failure to state a claim rather than under Rule 12(b)(1) as the district court did. Because the district court has diversity jurisdiction over the *Lerner* plaintiffs' state-law claims, we vacate the dismissal of the *Lerner* complaint and remand for adjudication of the *Lerner* state-law claims. We also vacate the dismissal of the *Bayroff* state-law claims and remand to the district court for determination whether the exercise of supplemental jurisdiction is appropriate in this case.

LEXSEE 146 F. Supp. 2d 224

ISAAC LERNER, ELI LERNER, BALLYWARD INVESTMENT COMPANY, LTD., JAIME SOHACHESKI, GASTON LIMITED, HOTEL INVESTORS, INC, PERKY LIMITED, ABRAHAM RAPPAPORT, ESTHER RAPPAPORT, MOSHE COHN, ESTABLISSEMENT SOMER, JOSEPH KOHN, CHANCERY ENTERPRISES, LTD, ROSDEV DEVELOPMENTS, INC., AND MICHAEL ROSENBERG, Plaintiffs, -against- FLEET BANK, N.A., STERLING NATIONAL BANK AND TRUST COMPANY OF NEW YORK, AND REPUBLIC NATIONAL BANK OF NEW YORK, Defendants. BRUCE BAYROFF, JOSHUA GOLDSTEIN, LAND TECH AT MANALPAN LLC, THEODORE BRODIE, MEYER ROSENBAUM, MR ASSOCIATES LLC, ILANA BLUMKIN, AS TRUSTEE, EMDEE TOURS, INC., ALEXANDER HANSENFELD, INC., PROFIT SHARING RETIREMENT PLAN, PINCHOS RUBINSON, AKIVA LEIMAN, ESTATE OF BORUCH RUBINSON, CHAIM AND RACHEL LEKOWITZ, NAFTALI AND SARAH LIPSHUTZ, MENDEL AND FEIGY LIPSHUTZ, REISEL BERGSTEIN, MICHAEL KONIG, ESTHER WERTENTEIL, AARON WERTENTEIL, TEENA RUBINFELD [sic], MARK WERTENTEIL, MORRIS AND SARAH FRIEDMAN, THE REGAL TRADE, S.A., VAVEL CORP., CHADWICK FUNDING CO. L.P., ALLEN SAUSEN AND LEONARD SAUSEN D/B/A ATASSCO, KEREN HACHESED OF MONSEY, INC., GENEVA PROPERTIES, L.L.C., MT. PLEASANT PARTNERS, HERSCEL KULEFSKY, ALBERT DAVID PEARLS & GEMS, INC., DEFINED BENEFIT PENSION PLAN, CHAI PROPERTIES CORP, ARTHUR KURTZ, CRESFIELD ASSOCIATES, INC., WEINREB MANAGEMENT AND HOWARD

MERMELSTEIN, Plaintiffs, -against- FLEET BANK, N.A., STERLING NATIONAL BANK AND TRUST COMPANY OF NEW YORK, AND REPUBLIC NATIONAL BANK OF NEW YORK, Defendants.

Action # 1 Case No. 98-CV-7778 (FB), Action # 2 Case No. 98-CV-7779 (FB)

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK

146 F. Supp. 2d 224; 2001 U.S. Dist. LEXIS 7001

May 22, 2001, Decided

COUNSEL:

For Plaintiffs: ERIC S. HORWITZ, ESQ., EDWARD S. RUDOFSKY, ESQ., Zane & Rudofsky, New York, NY.

For Fleet Bank, Defendant: RICHARD F. ZIEGLER, ESQ., Cleary, Gottlieb, Steen & Hamilton, New York, NY.

For Sterling National Bank, Defendant: ALLEN C. WASSERMAN, ESQ., TAMARA S. LOOMIS, ESQ., Owen & Davis, New York, NY.

For Republic National Bank, Defendant: CELIA G. BARENHOLTZ, ESQ., ADENA R. ABRAMSON, ESQ., Kronish, Lieb, Weiner & Hellman LLP, New York, NY.

JUDGES:

FREDERIC BLOCK, United States District Judge.

OPINION BY:

FREDERIC BLOCK

OPINION:

MEMORANDUM AND ORDER

BLOCK, District Judge:

Plaintiffs in both actions were investors who have been defrauded by David Schick ("Schick"), a prominent attorney and businessman. They have brought in each action identical multiple state law claims as well as federal Racketeer Influenced and Corrupt Organizations claims ("RICO") pursuant to 18 U.S.C. §§ 1962(c) and (d), seeking to recover in excess of $200 million from defendants Fleet Bank, N.A., Sterling National Bank and Trust Company of New York, and Republic National Bank of New York (collectively "defendants" or "banks") in connection with defendants' handling of certain bank accounts in a multi-million dollar Ponzi scheme orchestrated by Schick.[1] Plaintiffs rely on mail and wire fraud as the predicate acts constituting the RICO pattern of racketeering activity. As an association-in-fact RICO enterprise, plaintiffs name the New York State Attorney Disciplinary System. Plaintiffs claim that the enterprise was corrupted by the defendants because the banks allowed Schick to perpetuate his scheme for a protracted period of time by failing to report to the enterprise's Lawyers' Fund for Client Protection of the State of New York ("Lawyers' Fund") that Schick was writing checks against insufficient funds. Plaintiffs contend that if reporting had occurred,

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[1] The operative allegations in Action # 1 (*Lerner*) and Action # 2 (*Bayroff*) are identical. Accordingly, the Court consolidates them for purposes of these motions. *See Johnson v. Celotex Corp.*, 899 F.2d 1281, 1284 (2d Cir. 1990) (court has "broad discretion to determine whether consolidation is appropriate"); *see also* Fed. R. Civ. P. 42(a).

the Ponzi scheme would have been discovered sooner, curtailing their losses.

Defendants move to dismiss the RICO claims pursuant to Rule 12(b)(6) for a host of reasons, including plaintiffs' failure to plead the mail and wire fraud RICO components with Rule 9(b) particularity. Although not specifically referencing Rule 12(b)(1), defendants also challenge plaintiffs' standing. The Court agrees, albeit by separate analysis, that plaintiffs do not have standing and, accordingly, dismisses the RICO claims pursuant to Rule 12(b)(1) for lack of subject matter jurisdiction. Because the RICO claims are dismissed, and the Court declines to exercise supplemental jurisdiction, the complaints, as amended, are dismissed in their entirety.

BACKGROUND[2]

I. The Scheme

In 1992 Schick began marketing investment opportunities based upon mortgage flip transactions. Schick's "original intentions were good" and "his modus operandi was not criminal;" however, due to "unrelated losses stemming from a 1988 'problem' which came back to 'haunt' him," he began to use fraudulent means to stay afloat. Am. Compl. ¶ 3. The essence of Schick's scheme to defraud was the marketing of risk-free investments with high, short-term yields. In this regard, Schick purported to

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[2] All factual allegations are taken from the amended complaints. Paragraph references are to the *Bayroff* amended complaint (hereafter referred to as the "Am. Compl."). Their counterparts are otherwise numbered in the *Lerner* amended complaint.

bid on distressed mortgage pools at auctions and sales conducted by the Resolution Trust Company, Federal Deposit Insurance Corporation, and other banking institutions. Schick explained to prospective investors that after being awarded a bid to purchase a mortgage pool subject to at least a ninety-day due diligence, he could re-sell the same pool to a "take-out buyer" for a substantial profit (between twelve and twenty percent),[3] subject to a due diligence period of fewer than ninety days. Am. Compl. ¶ 126. Schick assured them that if the take-out buyer declined to purchase the pool, Schick could rescind the original purchase within his own ninety-day due diligence window, thus avoiding any risk of loss.

However, Schick told the putative investors that in order to close on a bid he was required to deposit substantial sums of cash as evidence of his ability to complete the purchase. Schick misrepresented to the investors that their investments would be protected in escrow accounts covered by restrictive provisions during the due diligence period, including a requirement that funds could not be withdrawn without the signature of plaintiffs' representative. Using these fraudulent promises as well as his status in the community, Schick successfully induced numerous individuals and entities to invest millions of dollars.

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[3] The amended complaints do not allege the percentage of this profit that would be paid to the investor.

II. Governing New York Regulations Regarding Attorney Escrow Accounts

Relevant to the RICO allegations set forth in the amended complaints, there are several regulations that govern the responsibilities and obligations of attorneys maintaining attorney escrow accounts and the banking institutions within which they are maintained. In particular, pursuant to Disciplinary Rule 9-102 of the Code of Professional Responsibility ("DR 9-102"):

> (B)(1) A lawyer who is in possession of funds belonging to another person incident to the lawyer's practice of law, shall maintain such funds in a banking institution within the State of New York which agrees to provide dishonored check reports in accordance with the provisions of Part 1300 of the joint rules of the Appellate Divisions. Banking institution means a state or national bank, trust company, savings bank, savings and loan association or credit union. Such funds shall be maintained, in the lawyer's own name, or in the name of a firm of lawyers of which he or she is a member, or in the name of the lawyer or firm of lawyers of whom he or she is employed, in a special account or accounts, separate from any business or personal accounts of the lawyer or lawyer's firm, and separate from any accounts which the lawyer may maintain as executor, guardian, trustee or receiver, or in any other fiduciary capacity, into which special account or accounts all funds held in escrow or otherwise entrusted to the lawyer or firm shall be deposited.
>
> (B)(2) A lawyer or the lawyer's firm shall identify the special bank account or accounts required by paragraph (1) of this subdivision as an

> "Attorney Special Account," or "Attorney Trust Account," or "Attorney Escrow Account," and shall obtain checks and deposit slips that bear such title. Such Title may be accompanied by such other descriptive language as the lawyer may deem appropriate, provided that such additional language distinguishes such special account or accounts from other bank accounts that are maintained by the lawyer or the lawyer's firm.

N.Y. Jud. Law App. at DR 9-102 (McKinney 2001) (codified at N.Y. Comp. Codes R. & Regs., tit. 22, § 1200.46[b][1], [2] (2001)). Furthermore, pursuant to the Dishonored Check Reporting Rules For Attorney Special, Trust and Escrow Accounts:

> (a) Special bank accounts required by [22 N.Y.C.R.R. § 1200.46] shall be maintained only in banking institutions which have agreed to provide dishonored check reports in accordance with the provisions of this section.
>
> (b) An agreement to provide dishonored check reports shall be filed with the Lawyer's Fund for Client Protection, which shall maintain a central registry of all banking institutions which have been approved in accordance with this section, and the current status of such agreement.
>
> (c) A dishonored check report by a banking institution shall be required whenever a properly payable instrument is presented against an attorney special, trust or escrow account which contains insufficient available funds, and the banking institution dishonors the instrument for that reason.
>
> . . . .

> (h) Every lawyer admitted to the Bar of the State of New York shall be deemed to have consented to the dishonored check reporting requirements of this section. Lawyers and law firms shall promptly notify their banking institutions of existing or new attorney special, trust or escrow accounts for the purpose of facilitating the implementation and administration of the provisions of this section.

22 N.Y.C.R.R. § 1300.1.

Each defendant is a banking institution as defined by the regulations, and each defendant has entered into a dishonored check reporting agreement with the Lawyers' Fund. The purpose of the Lawyers' Fund is "to promote public confidence in the administration of justice and the integrity of the legal profession by reimbursing losses caused by the dishonest conduct of attorneys admitted and licensed to practice law in the courts of New York State." 22 N.Y.C.R.R. § 7200.1. Claims for reimbursement of losses will be considered if

> (a)(1) the dishonest conduct alleged in the claim constituted the wrongful taking of money, securities or other property belonging to a law client or other person who entrusted it with an attorney admitted to the practice of law in New York State;
>
> (a)(2) the dishonest conduct occurred in the practice of law by an attorney admitted to practice law in New York State.

22 N.Y.C.R.R. § 7200.8. This regulation expressly exempts certain losses from eligibility for reimbursement, including "losses arising from financial transactions with attorneys that do not occur within an attorney-client relationship

and the practice of law." *Id.* at § 7200.8[d]. Furthermore, claims for reimbursement must be "written and verified," and include, *inter alia,* "the terms of the attorney's professional engagement." 22 N.Y.C.R.R. § 7200.9[a].

III. The RICO Theory

In addition to the Lawyers' Fund, the New York State Attorney Disciplinary System, the enterprise allegedly corrupted by the banks, is composed of the Appellate Division of the Supreme Court of the State of New York, the Departmental Disciplinary or Grievance Committee ("DDC/DGC") of each judicial department or district having jurisdiction, and all the approved banking institutions, such as the defendant banks, which have entered into written agreements with the Lawyers' Fund.

In support of their § 1962(c) RICO claim, plaintiffs maintain that defendants corrupted the enterprise, presumably because Schick was a major money-maker for the banks, by intentionally violating the reporting requirements of the governing regulations in three ways: First, by "knowingly and wrongfully" permitting Schick to open and maintain accounts under normal titles such as "Attorney-At-Law" and "As Attorney" when such accounts were being used as attorney escrow, attorney special and attorney trust accounts and should have been designated as such pursuant to DR 9-102, *see* Am. Compl. ¶ 7A(a); Second, by bouncing hundreds of checks written against such accounts due to insufficient funds, and not reporting these

overdrafts to the Lawyers' Fund,[4] *id.* at ¶ 7B; Third, by "returning checks unpaid, marked 'Refer to Maker,' in order to evade 'bouncing' and reporting Schick's checks," thereby allowing the banks to falsely represent that the checks were not paid because there was a "mix-up," such as a computer glitch or wrong account number, rather than because of insufficient funds. *Id.* at ¶ 8.

Plaintiffs allege that they would have early-on learned of Schick's scheme, and consequently been spared millions of dollars in losses, if the banks had reported Schick's check writing activities to the Lawyers' Fund because the Lawyers' Fund would have forwarded the banks' reports to the DDC/DGC, which would have compelled Schick to produce his records. Once Schick's defalcations were uncovered, the DDC/DGC would seek "immediate temporary suspension of the attorney." *Id.* at ¶ 88. Furthermore, those who suffered losses at Schick's hands could "be eligible for reimbursement of qualifying losses, up to a maximum of $100,000 per claim" from the Lawyers' Fund. *Id.* at ¶ 89.[5]

As for the mail and wire fraud predicate acts constituting the requisite pattern of racketeering activity, plaintiffs allege, in respect to mail fraud, that when the banks started to dishonor Schick's checks they returned them to the payees through the mails for insufficient

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[4] Although the amended complaints list checks that were dishonored, identifying the amount, date and name of the account on which the checks were drawn, they do not identify the payees.

[5] The statutory maximum on recovery has been increased to $300,000. *See* 22 N.Y.C.R.R. § 7200.13[a].

funds, while continuing to ignore the reporting requirements. *See id.* at ¶ 260. In addition, plaintiffs contend that in furtherance of the scheme to defraud, each defendant mailed a number of misleading monthly bank statements to Schick because "they did not include any reference whatsoever to the 'refer to maker' checks." *Id.* at ¶ 261. With respect to wire fraud, plaintiffs contend that the defendants "carried out instructions from Schick to transfer funds from the Schick Attorney Fiduciary Accounts, knowingly or recklessly disregarding the fact that Schick had overdrawn and was mulcting those accounts, and either (a) wired such funds directly from a Schick Attorney Fiduciary Account to one or more recipients located outside of the State of New York, or (b) credited those funds to another Schick or Schick-related account and then wired such funds from that account to one or more recipients located outside of the State of New York." *Id.* at ¶ 265.

In addition to their substantive § 1962(c) RICO claim, plaintiffs also allege a RICO conspiracy pursuant to § 1962(d). They claim that "based upon the conspicuous similarity and seamless continuity of the culpable acts and omissions . . . there came a point in time, prior to the public revelation of Schick's scheme, when each defendant knowingly and intentionally agreed with at least one other defendant to jointly corrupt the affairs of the Enterprise by perpetuating and continuing to perpetuate the Banks' Scheme in combination with one another." *Id.* at ¶ 125.

D. Motions to Dismiss

Although each defendant submits a separate motion to dismiss, the arguments presented for dismissal are substantially the same: (1) plaintiffs have not sufficiently

alleged standing pursuant to 18 U.S.C. § 1964(c); (2) plaintiffs have failed to plead a RICO enterprise; (3) plaintiffs have not sufficiently alleged that the defendants participated in the operation or management of the alleged enterprise; (4) predicate acts of mail fraud and wire fraud have not been pled with particularity; (5) plaintiffs have failed to plead a pattern of racketeering activity; and (6) in the absence of a substantive RICO violation, the RICO conspiracy claim must also fail. The Court need only address the standing issue.

DISCUSSION

The standard for dismissal under Rule 12(b)(1) is the same as under Rule 12(b)(6), namely "the court must accept as true all the factual allegations in the complaint and must draw all reasonable inferences in favor of the plaintiff." *Hamilton Chapter of Alpha Delta Phi, Inc. v. Hamilton College,* 128 F.3d 59, 63 (2d Cir. 1997); *see also Moore v. PaineWebber, Inc.,* 189 F.3d 165, 169 n.3 (2d Cir. 1999). The court should grant such a motion only if, after viewing the plaintiff's allegations in the most favorable light, "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson,* 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957); *see also Feder v. Frost,* 220 F.3d 29, 32 (2d Cir. 2000).

Standing under RICO is triggered by 18 U.S.C. § 1964(c), which states that "any person injured in his business or property *by reason of* a violation of section 1962 may sue . . . in any appropriate United States district court." (Emphasis added). As the Second Circuit has

formulated, RICO standing thereby requires "'(1) a violation of section 1962; (2) injury to business or property; and (3) causation of the injury by [reason of] the violation.'" *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 767 (2d Cir. 1994) (quoting *Hecht v. Commerce Clearing House, Inc.*, 897 F.2d 21, 23 (2d Cir. 1990)). Here, the substantive RICO violation is alleged to come within the purview of subdivision (c) of § 1962, which makes it "unlawful for any person . . . associated with any enterprise . . . to . . . participate . . . in the conduct of such enterprise's affairs through a pattern of racketeering activity." 18 U.S.C. § 1962(c). As in *Gelt* and *Hecht,* the causation focus under subdivision (c) invariably centers on the alleged predicate acts, consistent with the Supreme Court's statement in *Sedima, S.P.R.L. v. Imrex Co. Inc.*, 473 U.S. 479, 496, 87 L. Ed. 2d 346, 105 S. Ct. 3275 (1985), that "[a]ny recoverable damages by reason of a violation of § 1962(c) will flow from the commission of the predicate acts" because "the essence of the violation is the commission of those acts in connection with the conduct of the enterprise."

In *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258, 268, 117 L. Ed. 2d 532, 112 S. Ct. 1311 (1992), the Supreme Court made clear that the subdivision (c) predicate acts must be more than the "but for" cause of the plaintiff's injuries; they must be the proximate cause as well. Thus, the nexus between the violation and the injury cannot be too remote – there must be "some direct relation between the injury asserted and the injurious conduct alleged." *Id.* at 268. Embracing common law notions of proximate cause, the Court in *Holmes* noted that "a plaintiff who complained of harm flowing merely from the misfortunes visited upon a third person by defendant's

acts was generally said to stand at too remote a distance to recover." *Id.* at 268-69. As the Second Circuit subsequently postulated, "the critical question posed by the direct injury test is whether the damages a plaintiff sustains are derivative of an injury to a third party. If so, then the injury is indirect; if not, it is direct." *Laborers Local 17 Health & Benefit Fund v. Philip Morris, Inc.,* 191 F.3d 229, 238-39 (2d Cir. 1999).

In the context of mail and wire fraud predicate acts, the Second Circuit has conceptualized "but for" causation as "transaction causation," meaning "that *but for* the defendant's wrongful acts, the plaintiffs would not have entered into the transactions that resulted in their losses." *Moore,* 189 F.3d at 172. It views proximate cause as "loss causation," meaning that "the misrepresentation must be both an actual and a proximate source of the loss that the plaintiffs suffered." *Id.* at 170.

How then does the plaintiffs' RICO theory fit within this conceptual framework? Apart from whether the underlying predicate acts of mail and wire fraud can substantively support a RICO claim under plaintiffs' problematic allegations, or whether they are too remote to satisfy the direct injury test, the ultimate linchpin to plaintiffs' creative efforts to stretch a common law fraud case into a statutory civil RICO scenario are the reporting regulations that serve as the requisite associational link between the banks and the enterprise. However, regardless of whether or not defendants violated the reporting

requirements,[6] it seems to the Court that plaintiffs do not fall within the class of persons that these regulations seek to benefit. If such be the case, the concept of standing takes on a somewhat different aspect than the issue of proximate cause in the context of the violation of the predicate acts. Justice Scalia recognized this in his concurring opinion in *Holmes,* viewing it as a "zone-of-interests test" designed "to determine whether apart from the directness of the injury, the plaintiff is within the class of persons sought to be benefited by the provision at issue." 503 U.S. at 287. Although Justice Scalia recognized that this terminology "may not be entirely orthodox," he reasoned that viewing it as intermingled with general notions of proximate cause "would leave us bereft of terminology to connote those aspects of the 'violation-injury connection' aspect of standing that are distinct from proximate causality." *Id.* at 288 n.*.

Subsequent to *Holmes,* both the Seventh and Eighth Circuits have recognized the utility of the zone-of-interests

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[6] It is problematic whether the banks had a duty to report since the duty arises only when a payable instrument is presented "against an attorney special, trust or escrow account." 22 N.Y.C.R.R. § 1300.1[c]. Schick's accounts apparently were not so designated, and it is incumbent on the lawyer, not the bank, to make the appropriate designation. *See* 22 N.Y.C.R.R. § 1200.46[b][2]; *In the Matter of Ajello,* 275 A.D.2d 105, 712 N.Y.S.2d 600, 603-604 (2d Dep't 2000) (disbarring attorney for, *inter alia,* "failing to properly identify his IOLA account as an attorney trust account" in violation of DR 9-102); *In the Matter of Ryan,* 264 A.D.2d 128, 703 N.Y.S.2d 247, 251 (2d Dep't 2000) (same); *In the Matter of Orseck,* 262 A.D.2d 862, 692 N.Y.S.2d 766, 768 (3d Dep't 1999) (disciplining attorney for, *inter alia,* "failing to properly title the account in accordance with [ ] [DR 9-102]"). Because the Court's disposition of the case is not dependent on a resolution of this issue, it need not reach it.

test in assessing RICO standing. *See Newton v. Tyson Foods, Inc.*, 207 F.3d 444, 447 (8th Cir. 2000) (recognizing that the concept of zone-of-interests "can be helpful in analyzing RICO standing"); *Israel Travel Advisory Serv., Inc. v. Israel Identity Tours, Inc.*, 61 F.3d 1250, 1258 (7th Cir. 1995) ("[a] plaintiff claiming injury by the defendant's violation of a statute must show not only that the defendant violated the law but also that the plaintiff is among the persons protected by the law"); *see also Office of Workers' Comp. Programs v. Newport News Shipbuilding and Dry Dock Co.*, 514 U.S. 122, 127, 115 S. Ct. 1278, 131 L. Ed. 2d 160 (1995) (recognizing in related context that standing requires a litigant to show "that the interest he seeks to vindicate is arguably within the 'zone of interests to be protected or regulated by the statute' in question"). As for the Second Circuit, although it has cautioned that the zone of interests test "may not be substituted for the direct injury test in order to establish standing under RICO," *Laborers Local 17*, 191 F.3d at 236, it has nonetheless recognized that RICO causation embraces the question, "was the plaintiff in the category of people meant by the statute to be safeguarded," as well as the question of whether the harm that the plaintiff suffered was "that which the act meant to avoid." *Abrahams v. Young & Rubicam, Inc.*, 79 F.3d 234, 237 n.3 (2d Cir. 1996). Consequently, a RICO claim "stems from the fact that [plaintiff] was [ ] the target of the racketeering enterprise." *Id.* at 238 (internal quotation and citation omitted).

As admirable as the bank reporting requirements are, they are clearly designed to benefit an attorney's client in the context of the lawyer-client relationship; not investors who invest their monies with business people who also

happen to be lawyers. The regulatory scheme makes this clear.

Initially, by its express terms, DR 9-102(B)(1) requires separate accounts only where a lawyer possesses "funds belonging to another person incident to the lawyer's practice of law." 22 N.Y.C.R.R. § 1200.46[b][1]. To be "incident" to something, means "dependent upon, appertaining or subordinate to, or accompanying something arising or resulting from something else of greater or principal importance." *Black's Law Dictionary* 762 (6th ed. 1990). The regulatory language necessarily presumes that monies held in an escrow account which is identified as such by the attorney holding the account are monies paid in connection with the provision of legal services. The amended complaints are patently devoid of any allegation that the funds in Schick's bank accounts were deposited as a result of fees paid for legal representation, or were somehow being held incident to the practice of law. Investment funds are not funds held in escrow incident to the practice of law, and do not consequently come within the ambit of DR 9-102(B)(1). Notably, the plaintiffs do not refer to themselves as legal clients of Schick nor make reference to any factors that would connote a lawyer/client relationship.

Perhaps the most tell-tale sign that plaintiffs are not within the class of persons contemplated by the regulations governing the conduct of the alleged enterprise is that the regulations provide that any claim against the Lawyers' Fund for reimbursement of losses must relate to money "belonging to a law client," 22 N.Y.C.R.R. § 7200.8[a][1]; the dishonest conduct must have "occurred in the practice of law," *id.* at § 7200.8[a][2]; and the claim must set forth "the terms of the attorney's professional

engagement." *Id.* § 7200.9[a]. Furthermore, specifically excluded are "losses arising from financial transactions with attorneys that do not occur within an attorney-client relationship and the practice of law." *Id.* § 7200.8[d].

CONCLUSION

Defendants' motions to dismiss the RICO claims are granted. The Court declines to entertain supplemental jurisdiction over the state law claims and, accordingly, dismisses the amended complaints.

SO ORDERED.

FREDERIC BLOCK

United States District Judge

Dated: Brooklyn, New York

May 22, 2001

CORRECTED

United States Court of Appeals
FOR THE
SECOND CIRCUIT

(Filed Apr. 16, 2003)

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 16th day of April, two thousand and three.

Before: Hon. Chester J. Straub,
Hon. Sonia Sotomayor,
Circuit Judges
Hon. Richard W. Goldberg*,
Judge

Docket No. 01-7755

ISAAC LERNER, ELI LERNER, BALLYWARD INVESTMENT COMPANY, LTD., JAIME SOHACHESKI, GASTON LIMITED, HOTEL INVESTORS, INC, PERKY LIMITED; ABRAHAM RAPPAPORT, ESTHER RAPPAPORT, MOSHE COHN, ESTABLISSEMENT SOMER, JOSEPH KOHN, CHANCERY ENTERPRISES, LTD, ROSDEV DEVELOPMENTS, INC., MICHAEL ROSENBERG, BRUCE BAYROFF, JOSHUA GOLDSTEIN, LAND TECH AT MANALPAN LLC., THEODORE BRODIE, MEYER ROSENBAUM, MR ASSOCIATES LLC., ILANA BLUMKIN, As Trustee, Emdee Tours, Inc., ALEXANDER HANSENFELD, INC., PROFIT SHARING RETIREMENT PLAN, PINCHOS RUBINSON, AKIVA LEIMAN, ESTATE OF BORUCH RUBINSON, CHAIM

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* The Honorable Richard W. Goldberg of the United States Court of International Trade, sitting by designation.

LEKOWITZ, RACHEL LEKOWITZ, NAFTALI LIPSHUTZ, SARAH LIPSHUTZ, MENDEL LIPSHUTZ, FEIGY LIPSHUTZ, REISEL BERGSTEIN, MICHAEL KONIG, ESTHER WERTENTEIL, MARK WERTENTEIL, MORRIS FRIEDMAN, SARAH FRIEDMAN, AARON [ILLEGIBLE], TEENA WERTENTEIL, THE REGAL TRADE, S.A., VAVEL CORP., CHADWICK FUNDING CO. L.P., ALLEN SAUSEN, LEONARD SAUSEN D/B/A Atassco, KEREN HACHESED OF MONSEY, INC., GENEVA PROPERTIES, L.L.C., MT. PLEASANT PARTNERS, HERSCEL KULEFSKY, ALBERT DAVID PEARLS & GEMS, INC., DEFINED BENEFIT PENSION PLAN, CHAI PROPERTIES CORP, ARTHUR KURTZ, CRESFIELD ASSOCIATES, INC., WEINREB MANAGEMENT, HOWARD MERMELSTEIN,

Plaintiffs-Apellant,

v.

FLEET BANK, N.A., STERLING NATIONAL BANK AND TRUST COMPANY OF NEW YORK and REPUBLICAN NATIONAL BANK OF NEW YORK,

Defendants-Appellees.

Appeal from the United States District Court for the Eastern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Eastern District of New York and was argued by counsel.

On consideration whereof, it is hereby ORDERED, ADJUDGED and DECREED that the judgment of said district court be and it hereby is AFFIRMED IN PART, VACATED AND REMANDED IN PART in accordance with the amended opinion of this Court.

FOR THE COURT:
ROSE ANN B. MACKECHNIE,
Clerk
by

/s/ Arthur M. Heller
Arthur M. Heller
Motions Staff Attorney

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

ROSEANN B. MACKECHNIE
CLERK

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 7th day of May two thousand three.

Isaac Lerner, et al

Plaintiffs-Appellants

v

Dkt No: 01-7755

FLEET BANK, N.A., STERLING NATIONAL BANK AND TRUST COMPANY OF NEW YORK and REPUBLIC NATIONAL BANK OF NEW YORK,

Defendants-Appellees.

(Filed May 7, 2003)

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the appellant Isaac Lerner, et al.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular

active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

ROSEANN B. MACKECHNIE, Clerk

By: /s/ Arthur M. Heller
Arthur M. Heller,
Administrative Attorney

United States District Court
Eastern District of New York

ISAAC LERNER, ELI LERNER, BALLYWARD INVESTMENT COMPANY, LTD., JAIME SOHACHESKI, GASTON LIMITED, HOTEL INVESTORS, INC., PERKY LIMITED, ABRAHAM RAPPAPORT, ESTHER RAPPAPORT, MOSHE COHN, ESTABLISSEMENT SOMER, JOSEF KOHN, CHANCERY ENTERPRISES, LTD., ROSDEV DEVELOPMENTS, INC., AND MICHAEL ROSENBERG,	X	DOCKET NO. CV98 7778
Plaintiffs,	:	BLOCK, J.
- AGAINST -	:	MANN, M.J.
FLEET BANK, N.A., STERLING NATIONAL BANK AND TRUST COMPANY OF NEW YORK, AND REPUBLIC NATIONAL BANK OF NEW YORK,	:	
Defendants.	X	

[EXCERPTS OF] AMENDED COMPLAINT
(Jury Trial Demanded)

Plaintiffs, by their attorneys, G. Robert Blakey and Zane and Rudofsky, as and for their Amended Complaint in this action allege as follows:

PRELIMINARY STATEMENT

1. In a highly publicized case, David Schick ("Schick"), previously a well respected lawyer recently

plead guilty in the Southern District of New York and the Eastern District of New York to bilking approximately $180 million from unsuspecting clients and investors who had the terrible misfortune of placing their savings and monies with him in investments, frequently in "attorney-at-law", "escrow", "special" and/or "trust" accounts at defendants' banks. Schick's financial empire unraveled in April, 1996. He then admitted his "fraud" and involuntary bankruptcy proceedings were commenced against him. Since then, a small army of law firms and forensic accountants have spent millions of dollars in fees and expenses, and endless efforts have brought a multitude of actions, all in an effort to unravel Schick's convoluted financial dealings.

* * *

4. Critical aspects of the Banks' Scheme have previously eluded detection by the minion of lawyers and accountants who have sought to unravel the *modus operandi* of Schick's "scheme" and determine how he was able to "bounce" approximately 500 "attorney-at-law", "escrow", "trust["] and "special" account checks involving in excess of $34 million, over a period of three years, without detection or disciplinary action. Beyond peradventure, detection of Schick's "bounced checks" and his suspension/disbarment from the practice of law, early on in his "scheme," would have saved plaintiffs, and others, from becoming "victims" of his fraud.

5. This Complaint asserts Civil RICO liability and state law claims against defendants. The gravamen of the RICO claim establishes defendants' corruption and manipulation of the "New York State Attorney Disciplinary System", an association-in-fact enterprise over which

defendants, as participants, exclusively controlled and directed critical, outcome-determinative

6. The Banks' Scheme, as hereinafter alleged, was conceived and implemented *without* Schick's involvement. It involved high level corporate bank officials, not only the Branch Managers/Account Officers, but also District Managers, supervisors, senior credit officers, responsible "compliance" officers, "back office" managers, internal bank auditors, bank legal counsel, Vice Presidents, Senior Vice Presidents, Executive Vice Presidents, and, in at least one instance, the President and Chairman of the Board of a defendant bank. A single bank officer, at each Bank, acting alone, could not have implemented, nor carried out either the Banks' Scheme, at each Bank, nor manipulated the Banks' records accordingly.

7. Prior to public disclosure of Schick's financial debacle, inexplicably none of defendant banks ever reported even one single "bounced check", of the 500 or more checks Schick bounced over a period of three years, to The Lawyers' Fund for Client Protection of the State of New York (the "Lawyers' Fund"), as required by (i) law, and (ii) written contracts by each defendant bank with the Lawyers' Fund.

7A. (a) An important aspect of the Banks' Scheme, not previously recognized nor alleged by any other of the Schick victims, is that in order to corruptly evade the obligation to report Schick's "bounced" checks to the Lawyers' Fund, the Banks knowingly and wrongfully permitted Schick in his own name and in the names of Frenkel & Hershkowitz and Schick & Simon to (*i*) open and maintain accounts required by law to be, but, at times, not, initially designated as "special", "trust" or

"escrow" accounts, and which were thereafter used as such by Schick with the Banks' knowledge and consent, under similar and deliberately deceptive titles such as "Attorney-at-Law", "As Attorney", etc. ("'attorney-at-law' accounts"), and/or (*ii*) utilize such attorney-at-law accounts to deposit, commingle, and/or misappropriate, and/or unlawfully deal with "funds belonging to another person" and possessed by Schick "incident to his . . . practice of law" as hereafter alleged.

(b) The Banks "bounced" hundreds of checks written on such Schick attorney-at-law accounts for insufficient funds without reporting any of those "bounced checks" to the Lawyers' Fund. By so doing, defendants (i) fraudulently evaded regulatory reporting requirements which would have resulted in Schick's immediate suspension and/or early disbarment, (ii) falsified banking records as to the essential nature of the accounts, (iii) obstructed governmental administration, (iv) corrupted the RICO "enterprise" of which they were members, the "New York State Attorney Disciplinary System", and (v) defrauded plaintiffs, as well as other victims.

(c) Schick's aforesaid attorney-at-law accounts were tantamount to, and coextensive in fact and meaning with, the Schick "Attorney Fiduciary Accounts["] as to which defendant Banks were required to provide Dishonored Check Reports to the Lawyers' Fund in accordance with the provisions of Part 1300 of the rules of the Appellate Division.

7B. The Banks' knowing failure to enforce the legal requirements that "funds belong to another person" possessed by Schick "incident to his practice of law" be segregated in "special bank accounts" with the required

designations, and its concomitant failure to report hundreds of "bounced" checks written on those accounts to the Lawyers' Fund, corrupted, undermined and made a complete mockery of the "Dishonored Check Reporting Rules for Attorney Special, Trust and Escrow Accounts" by which the Banks agreed to be bound.

8. Another new aspect of the Banks' Scheme, never previously detected by any other Schick victim, nor lawyers, forensic accountants, Schick's Bankruptcy Trustees, nor their representatives, nor raised in any previous litigation against defendant banks, as alleged below, reveals for the first time bank corruption by use of a deceptive "Refer to Maker" scheme (i.e., by returning checks unpaid, marked "Refer to Maker") in order to evade "bouncing" and reporting Schick's checks for "insufficient funds" (although that was the reason the checks "bounced"), which would have necessitated reporting to the Lawyers' Fund. Thereafter, defendants each knowingly falsely told plaintiffs that the checks were returned unpaid, marked "Refer to Maker", simply because there was a "mix-up" (e.g., "there was a computer glitch at the bank"; "the check was written on the wrong account, Schick will replace it"), rather than the true reason, that being "insufficient available collected funds". By so doing, defendants (i) fraudulently evaded regulatory reporting requirements which would have resulted in Schick's immediate suspension and/or early disbarment, (ii) falsified banking records, (iii) obstructed governmental administration, (iv) corrupted the RICO "enterprise" of which they were members, "The New York State Attorney Disciplinary System", and (v) defrauded plaintiffs, as well as other victims.

8A. A single bank officer, at each Bank, could not have implemented, nor carried out the "Refer to Maker" scheme, at each Bank, nor manipulated each bank's records accordingly.

9. By use of the "Refer to Maker" device for returning Schick's checks rather than marking them "Insufficient Funds", the banks made detection of their corruption nearly impossible, since as hereafter explained, "Refer to Maker" returned checks did **not** appear on Schick's monthly bank statements which were mailed to Schick and subsequently turned over to Schick's Bankruptcy Trustees.

10. Consequently, those unpaid "Refer to Maker" checks have never been listed or available to those investigating the Schick debacle and the banks' involvement. Although the Schick Bankruptcy Trustee's forensic accountants have spent thousands of hours reviewing copies of Schick's bank statements and "bounced checks" allegedly produced by defendant banks under subpoena, however, not a single "Refer to Maker" returned unpaid Schick check was produced by defendant banks nor appears on those accountants' "Return Item Credit Entries Report" in the bankruptcy case. Plaintiffs, however, do have Schick checks returned unpaid by each defendant bank, marked "Refer to Maker", as hereinafter alleged. Upon information and belief, discovery in this action, will reveal a multitude of additional checks similarly and fraudulently returned "Refer to Maker" by defendants.

11. A month after public disclosure of Schick's insolvency, the "Senior Vice President" of one defendant bank, as hereinafter alleged, for the first time advised the Lawyers' Fund that Schick checks had been returned

unpaid for "Insufficient Funds". Plaintiffs will demonstrate that this after-the-fact letter was an acknowledgement of that defendant's previously unfulfilled bank reporting requirement obligations regarding "bounced checks" and constitutes a clear "consciousness of guilt". The fact that the letter came from the bank's "Senior Vice President" evidences participation of "high level" bank officers in the Bank's Scheme to evade regulatory reporting and corruption of the "New York State Attorney Disciplinary System."

12. Defendants caused numerous mailings to be sent to other banks, to plaintiffs and to other victims continuously during the Banks' Scheme, giving their conduct a veneer of legitimacy. All of these mailings are alleged to constitute "predicate acts" of mail fraud as hereafter set forth.

13. In this action, fifteen (15) plaintiffs seek recovery of $18,000,847.64 from defendants, representing plaintiffs' losses in Schick investments, including monies deposited in Schick's "attorney-at-law", "escrow", "special" and "trust" accounts at defendant banks. Plaintiffs further allege that "but for" defendants' fraud and its corruption of the "New York State Attorney Disciplinary System," Schick's financial defalcations would have been discovered had defendants timely made the required reporting to the Lawyers' Fund which would have resulted in Schick's immediate suspension and/or disbarment before plaintiffs' entrusted their funds with him and/or the funds were misappropriated and/or plaintiffs suffered damages. State law claims, *inter alia*, alleging common law fraud, aiding and abetting the breach of Schick's fiduciary duties, breach of contract, negligence and strict liability are also asserted.

14. This Complaint alleges that independent of Schick, the banks separately and/or jointly engaged in racketeering activities corrupting an "enterprise" at a level which they alone controlled, operated and managed. This Complaint is thus about the Banks' Scheme – which the defendants solely "orchestrated" and perpetrated using bank personnel and facilities which they alone solely controlled and operated.

* * *

15. At all times relevant to this action, Fleet has had a duty, among other things, to report to the New York State Lawyers' Fund for Client Protection, pursuant to 22 NYCRR §§ 1200.46(1) and (2), and 1300.00, and by written contract, as alleged herein, all checks drawn by attorneys on "special", "trust" or "escrow" accounts which are returned because of insufficient available collected funds to honor such instruments.

* * *

36. At all times relevant to this action, Sterling has had a duty, among other things, to report to the New York State Lawyers' Fund for Client Protection, pursuant to 22 NYCRR §§ 1200.46(1) and (2), and 1300.00, and by written contract, as alleged herein, all checks drawn by attorneys on "special", "trust" or "escrow" accounts which are returned because of insufficient available collected funds to honor such instruments.

* * *

38. At all times relevant to this action, Republic has had a duty, among other things, to report to the New York State Lawyers' Fund for Client Protection, pursuant to 22 NYCRR §§ 1200.46(1) and (2), and 1300.00, and by written

contract, as alleged herein, all checks drawn by attorneys on "special", "trust" or "escrow" accounts which are returned because of insufficient available collected funds to honor such instruments.

OVERVIEW OF THE "ENTERPRISE"

39. The "enterprise" alleged in this Complaint, within the meaning of 18 U.S.C. §1961(4), and which defendants corrupted by their fraudulent acts as elsewhere alleged in this Complaint, is the **New York State Attorney Disciplinary System** (hereinafter the "Enterprise"), and consists of *(A)* the **Appellate Division of the Supreme Court of the State of New York** ("Appellate Division"), *(B)* the **Departmental Disciplinary** or **Grievance Committee** of each judicial department or district having jurisdiction, *(C)* the **Lawyers' Fund for Client Protection of the State of New York** ("Lawyers' Fund"), and *(D)* the **Approved Banking Institutions** which have entered into written agreements with the Lawyers' Fund, pursuant to Title 22 of the New York Code, Rules & Regulations ("N.Y.C.R.R."), Part 1300, to provide "Dishonored Check Reports" and are, therefore, the only depositories permitted to accept attorney "special", "trust," or "escrow" accounts from attorneys in the State of New York. The purpose of the Enterprise was and is not to defraud individuals such as plaintiffs, but rather to regulate the conduct of attorneys admitted to practice law in the State of New York and to impose discipline for misconduct, with continuity and a distinct structure beyond the alleged fraud and corruption of defendants. The other aspects of the Enterprise are hereinafter described.

* * *

HIERARCHY AND STRUCTURE OF THE ENTERPRISE

49. Pursuant to New York Judiciary Law § 90, the Appellate Division is, and at all times relevant hereto was, responsible for the admission to practice, regulation and discipline of attorneys.

50. Each department of the Appellate Division has, and at all times relevant hereto had, adopted rules regulating the admission to practice, regulation and discipline of attorneys, including but not limited to provisions for Departmental Disciplinary and/or Grievance Committees.

51. In particular, at all times relevant hereto, to and including the present, *(A)* pursuant to 22 N.Y.C.R.R., Part 605, the Appellate Division, First Department, has provided that complaints of attorney misconduct shall be considered by the Departmental Disciplinary Committee ("DDC"), and *(B)* pursuant to 22 N.Y.C.R.R., Part 691, the Appellate Division, Second Department, has provided that complaints of attorney misconduct shall be considered by three (3) grievance committees organized on a judicial district-by-district basis (each committee hereinafter referred to as a "Departmental Grievance Committee" or "DGC").

52. The Lawyers' Fund is, and at all times relevant hereto was, organized pursuant to 22 N.Y.C.R.R., Part 7200.

53. The purpose of the Lawyers' Fund "is to promote public confidence in the administration of justice and the integrity of the legal profession by reimbursing losses caused by the dishonest conduct of attorneys admitted and

licensed to practice law in the courts of New York State." [22 N.Y.C.R.R. § 7200.1]

54. The trustees of the Lawyers' Fund are authorized, *inter alia,* to "investigate claims for reimbursement of losses" [22 N.Y.C.R.R. § 7200.4(c)], "coordinate and cooperate with the Appellate Divisions [sic] of the Supreme Court in the investigation of claims" [22 N.Y.C.R.R. § 7200.4(d)], "prosecute claims for restitution to which the [F]und may be entitled" [22 N.Y.C.R.R. § 7200.4(h)], and pay claims arising out of "the wrongful taking of money, securities or other property belonging to a law client or other person who entrusted it with an attorney admitted to the practice of law in New York" [22 N.Y.C.R.R. § 7200.8(a)(1)], subject to a maximum payment of $100,000, per claimant [22 N.Y.C.R.R. § 7200.13(a)].

55. Pursuant to 22 N.Y.C.R.R. § 1200.46, *inter alia,* all attorney "special", "escrow" and/or "trust" accounts (including "IOLA" accounts maintained pursuant to New York Judiciary Law § 497) are, and at all times relevant hereto were, required to be maintained in "a banking institution within the State of New York which agrees to provide dishonored check reports in accordance with the provisions of Part 1300 of the rules of the Appellate Division." Such "special", "escrow" and "trust" accounts (including IOLA accounts) are hereinafter sometimes referred to collectively as the "Schick Attorney Fiduciary Accounts."

56. Pursuant to 22 N.Y.C.R.R., Part 1300:

> Special bank accounts required by Disciplinary Rule 9-102 (22 NYCRR 1200.46) **shall** be maintained **only** in banking institutions which have

agreed to provide dishonored check reports in accordance with the provisions of this section.

An agreement to provide dishonored check reports shall be filed with the Lawyers' Fund for Client Protection, which shall maintain a central registry of all banking institutions which have been approved in accordance with this section, and the current status of each such agreement. The agreement shall apply to **all branches** of each banking institution that provides special bank accounts for attorneys engaged in the practice of law in this [S]tate, and shall not be cancelled by a banking institution except on thirty days prior written notice to the Lawyers' Fund for Client Protection.

A dishonored check report by a banking institution shall be required whenever a properly payable instrument is presented against an attorney special, trust or escrow account which contains insufficient available funds, and the banking institution dishonors the instrument for that reason. A "properly payable instrument" means an instrument which, if presented in the normal course of business, is in a form requiring payment under the laws of the State of New York.

A dishonored check report shall be substantially in the form of the notice of dishonor which the banking institutions customarily forwards to its customer, and may include a photocopy or computer-generated duplicate of such notice.

Dishonored check reports shall be mailed to the Lawyers' Fund for Client Protection, 55 Elk Street, Albany, New York 12210, within

five banking days after the date of presentment against insufficient available funds.

The Lawyers' Fund for Client Protection shall hold each dishonored check report for ten business days to enable the banking institution to withdraw a report provided by inadvertence or mistake; except that the curing of an insufficiency of available funds by a lawyer or law firm by the deposit of additional funds shall not constitute a reason for withdrawing a dishonored check report.

After holding the dishonored check report for ten business days, **the Lawyers' Fund for Client Protection shall forward it to the attorney disciplinary committee for the judicial department or district having jurisdiction over the account holder,** as indicated by the law office or other address on the report, for such inquiry and action that attorney disciplinary committee deems appropriate.

Every lawyer admitted to the Bar of the State of New York shall be deemed to have consented to the dishonored check reporting requirements of this section. Lawyers and law firms shall promptly notify their banking institutions of existing or new attorney special, trust, or escrow accounts for the purpose of facilitating the implementation and administration of the provisions of this section.

[Emphases added.]

("[B]anking institutions which have been approved [by the Lawyers' Fund] in accordance with this section," i.e., Part 1300, are referred to in this Complaint as "Approved Banking Institutions.")

57. In respect of the Dishonored Check Reporting Rules and discipline of attorneys for violating fiduciary responsibility with respect to the Schick Attorney Fiduciary Accounts as provided in 22 N.Y.C.R.R. § 1200.46, the New York State Attorney Disciplinary System is hierarchical in that *(A)* the Approved Banking Institution is responsible for reporting checks dishonored by reason of insufficiency of available funds to *(B)* the Lawyers' Fund, which in those cases in which the report is not withdrawn, is responsible for forwarding the report ("Dishonored Check Report") to *(C)* the DDC or DGC with jurisdiction, which is responsible for applying, in appropriate cases, to *(D)* the Appellate Division with jurisdiction for the imposition of discipline on attorneys guilty of professional misconduct (i.e., suspension or disbarment).

58. This hierarchy may be diagrammatically summarized as follows:

59. Upon receipt of a Dishonored Check Report, the DDC or DGC with jurisdiction in virtually all cases compels the involved attorney to produce the records of the account on which the dishonored check is drawn, pursuant to 22 N.Y.C.R.R. § 1200.46(h) and applicable Court Rules

permitting Disciplinary or Grievance Counsel to issue, or request the issuance of, subpoenae for such purpose.

60. In serious cases involving failure on the part of the attorney to cooperate in the investigation, or involving numerous "bounced" checks, or large amounts of money, the DDC or DGC seeks immediate temporary suspension of the attorney pursuant to Judiciary Law § 90, 22 N.Y.C.R.R. § 1200.46(i), and applicable Court Rules permitting applications for such relief.

61. Upon an attorney being suspended or disbarred from practice, clients and other victims who have suffered "escrow" losses at the hands of the suspended/disbarred attorney may be eligible for reimbursement of qualifying losses, up to a maximum of $100,000 per claimant [22 N.Y.C.R.R. § 7200.8 et seq.], but taking into account "the amount of money available and likely to become available to the [F]und for the payment of claims, and the size and number of claims that have been or are likely to be presented" [22 N.Y.C.R.R. § 7200.10(i)(1)] and "the amount of the claimant's loss as compared with the amount of losses sustained by other claimants who may merit reimbursement from the [F]und" [22 N.Y.C.R.R. § 7200.10(i)(2)] as well as other enumerated and "appropriate" factors [22 N.Y.C.R.R. § 7200.10(i), incl. subd. (3) through (5)].

"MANAGEMENT" AND/OR *"OPERATION"* OF THE ENTERPRISE BY [ ] THE APPROVED BANKING INSTITUTIONS

62. The Approved Banking Institution plays a **key role** in the Enterprise and has **exclusive control** over the **pivotal decision** of whether to honor or dishonor a check drawn on an Attorney's Fiduciary Account in instances when

there are "insufficien[t] available funds" in such attorney's account.

63. Upon the presentment of a check drawn on an Attorney's Fiduciary Account, an Approved Banking Institution may either honor (pay) or dishonor (return unpaid) the instrument.

64. The decision to honor or dishonor an instrument in the case of an "overdraft" (i.e., "insufficiency of available funds") is a managerial or operational credit decision customarily made by the branch manager, credit committee or other senior bank officer with the authority to do so, depending on the amount of the overdraft, except as with respect to the Schick Attorney Fiduciary Accounts, where "overdrafts" are prohibited.

65. The honor or dishonor of the instrument upon presentment is, therefore, **exclusively within the control of the Approved Banking Institution**.

66. In those cases in which an instrument is dishonored, the Approved Banking Institution is required by the applicable provisions of the New York Uniform Commercial Code, the Federal Reserve Act, the Regulations of the Federal Reserve System, the Operating Circulars of the New York Federal Reserve Bank, and the Constitution, Administrative Procedures and Rules of the New York Clearing House Association, to give "Notice of Dishonor" which is not deceptive to the bank presenting the instrument for collection.

67. The form of "Notice of Dishonor" given to the bank presenting the instrument for collection is **exclusively within the control of the Approved Banking Institution.**

68. In those cases in which a check drawn on an Attorney's Fiduciary Account is presented for payment at a

time when the account upon which the check is drawn has insufficient available collected funds to pay the check, and the check is dishonored, the decision as to what stated reason (actual or purported) to give for dishonor – i.e., "insufficient funds" or some other stated reason, whether true or false, and whether or not misleading – is **exclusively within the control of the Approved Banking Institution.**

69. In those cases in which a check drawn on an Attorney's Fiduciary Account is presented for payment at a time when the account upon which the check is drawn has insufficient available collected funds to pay the check, and the check is dishonored, it is **exclusively within the control of the Approved Banking Institution** whether to give "insufficient available funds" as the stated reason for dishonor, thereby requiring a Dishonored Check Report to the Lawyers' Fund and, ultimately, the DDC/DGC, as the case may be, or to return the instrument in question with some other reason for dishonor, or explanatory legend, not requiring a Dishonored Check Report.

70. In those cases in which a check drawn on an Attorney's Fiduciary Account (including a "special", "escrow" or "trust" account, and an attorney-at-law" account which the Bank knows is being used as a "special", "escrow" or "trust" account without being designated as such) is presented for payment at a time when the account upon which the check is drawn has insufficient funds available to pay the check, and the check is dishonored for that reason, it is **exclusively within the control of the Approved Banking Institution** whether or not to make a Dishonored Check Report as required by both the Dishonored Check Reporting Rule and by the written

agreement between the Approved Banking Institution and the Lawyers' Fund.

71. The Approved Banking Institution plays a critical **managerial and operational role** in the New York State Attorney Disciplinary System, which is outcome-determinative of its effectiveness, in respect of dishonored Attorney Fiduciary Account checks drawn by an attorney, in that, in the event the Approved Banking Institution does not report the dishonored checks to the Lawyers' Fund, **(a)** neither the Lawyers' Fund, nor the DDC/DGC (as the case may be), nor the Appellate Division, will ever learn of the dishonor and any underlying attorney misconduct, thereby fraudulently manipulating the system (the Enterprise) and preventing disciplinary action against the dishonest lawyer, and **(b)** the dishonest attorney is left free to mulct more and more money from the same and additional victims, in an ever-expanding scheme, making it financially impossible for the Lawyers' Fund to "reimburse losses caused by the dishonest conduct" of the attorney, due to the limited resources of the Lawyers' Fund, and thereby undermining the stated purposes of the Lawyers' Fund.

72. By reason of the foregoing, the Approved Banking Institution is central to management and operation of the "system" (the Enterprise) and in controlling and directing an essential aspect of the Enterprise's affairs and, as elsewhere alleged herein, defendants thereby exerted managerial and operational control over the Enterprise.

73. Defendants (i.e., not Schick) conceived of, devised and determined the *modus operandi* and implemented the Banks' Scheme to corrupt the Enterprise, coordinating,

orchestrating, managing and exerting substantial control over a crucial portion of the Enterprise and played the central role in managing and operating that scheme and directed others to act in furtherance thereof.

How the Defendant Banks Corrupted and Undermined the "Enterprise" (the Attorney Discipline System) in this Case

74. Each Defendant is, and since 1992, has been an Approved Banking Institution.

75. Each Defendant in 1992 entered into a Dishonored Check Reporting Agreement with the Lawyers' Fund.

76. At certain times relevant to this action, between 1992 and 1996, Schick maintained, *inter alia*, the following ("Schick Attorney Fiduciary Accounts") in branches of defendant banks located in the State of New York and subject to the Dishonored Check Reporting requirements:

Name of Bank	Account Name	Account Number
Fleet	David Schick, Attorney-at-law	0771003183
Fleet	David Schick	0773008036
Fleet	David Schick, Attorney-at-law	9387339156
Fleet	David Schick, Frenkel & Hershkowitz	9387489197
Fleet	David Schick, Attorney-at-law	9387490630
Fleet	David Schick-Special Account	9387490649

Republic National	David Schick, Esq., Attorney-at-law	0311232884
Republic National	David Schick, Esq.	0311232889
Republic National	David Schick, Esq., Escrow Account	0311245439
Sterling National	David Schick, Attorney-at-law Special Account	0315395000
Sterling National	David Schick-Special Account	0315395001

77. At certain times relevant to this action, between 1992 and 1996, Schick was a member of the law firm of Frenkel & Hershkowitz, which maintained, *inter alia*, the following "Schick Attorney Fiduciary Accounts["] (also sometimes referred to as the "F&H Attorney Fiduciary Accounts") in branches of defendant banks located in the State of New York and subject to the Dishonored Check Reporting requirements:

Name of Bank	Account Name	Account Number
Fleet	Frenkel & Hershkowitz	7711005980
Fleet	Frenkel & Hershkowitz, As Attorney, David Schick	9379131400
Fleet	Frenkel & Hershkowitz, as Attorney, David Schick	9380019803
Fleet	Frenkel & Hershkowitz, David Schick-Special	9382601987
Fleet	Frenkel & Hershkowitz, as Attorney Schick/Shafran	9387339113

Fleet	Frenkel & Hershkowitz, Attorney Trust c/o Schick	9387339121
Fleet	Frenkel & Hershkowitz, Attorney Trust-Special	9387680434

78. At certain times relevant to this action, between 1992 and 1996, Schick was a member of the law firm of Schick & Simon, which maintained, *inter alia*, the following "Schick Attorney Fiduciary Accounts" (also sometimes referred to as the "S&S Attorney Fiduciary Accounts") in branches of defendant banks located in the State of New York and subject to the Dishonored Check Reporting requirements:

Name of Bank	Account Name	Account Number
Fleet	Schick & Simon, Attorneys at Law	9387490534
Fleet	Schick & Simon, Attorneys at Law	9387490622
Republic National	Schick & Simon (IOLA)	0310323029

79. The "Schick Attorney Fiduciary Accounts", "F&H Attorney Fiduciary Accounts" and "S&S Attorney Fiduciary Accounts" are referred to in this Complaint, collectively, as the "Schick Attorney Fiduciary Accounts."

79A. The Schick Attorney Fiduciary Accounts include accounts (i) designated as "escrow," "trust" or "special" accounts, and (ii) "attorney-at-law" and other accounts, not so designated, which the Banks knew were being used by Schick to maintain funds belonging to other person(s) and which he possessed incident to his practice

of law, and which therefore were **required** to be maintained in "special bank accounts" so designated in accordance with 22 N.Y.C.R.R., Part 1200.

79B. The Banks knew this, *inter alia*, because of (a) written "escrow" agreements provided to the Banks, (b) references to "escrow" agreements in wire transfer requests and/or confirmations, and (c) numerous occasions on which there were insufficient funds in order to honor checks drawn by Schick on such accounts and Schick expressly remarked to bank officers, in words or substance, that outstanding checks drawn on such accounts "had" to be covered because the funds involved were the property of others and dishonor of the checks would, *inter alia*, result in Schick's own scheme being exposed.

79C. In pertinent part, 22 N.Y.C.R.R. § 1200.46(b) mandates that "funds belongs to another person" in the possession of an attorney "incident to the lawyer's practice of law" must be maintained "in a special account or accounts, separate from any business or personal accounts of the lawyer or lawyer's firm" [§ 1200.46(b)(1)] and that such "special bank account or accounts" must be identified as "Attorney Special Account", ["]Attorney Trust Account", or "Attorney Escrow Account" [§1200.46(b)(2)].

79D. The "special bank account" requirements of § 1200.46(b) are specifically referred to in 22 N.Y.C.R.R. §1300.1(a).

79E. The "segregated bank account" requirements are specifically recited in each written agreement between the Banks and the Lawyers' Fund, to which a copy of the "court rules authorizing this agreement are attached."

79F. At all times relevant hereto the Banks had actual knowledge of the "special bank account" requirements of § 1200.46(b)(1) and (2), *inter alia,* by reason of (a) the written agreements between the Banks and the Lawyers' Fund, referring to such rules, and (b) the compliance efforts of their other lawyer customers, including changing of account titles and printing of new checks and deposit slips in accordance with the rules.

79G. With respect to the "attorney-at-law" accounts maintained by Schick and the Schick Law Firms, each Bank was either aware, *ab initio,* or became aware prior to the collapse of Schick's scheme, that Schick was wrongfully depositing the funds of other persons into accounts which should have been, but, at times, were not initially designated by Schick, and/or the Bank(s) as "special", "escrow" or "trust" accounts, and/or was utilizing such accounts for the deposit of "escrow" funds which were designated with misleading account titles so as to create the misleading impression that such accounts were "special", "escrow" or "trust" accounts, and that Schick was wrongfully commingling and/or misappropriating such funds, and writing checks on such "attorney-at-law" accounts against insufficient funds therein. The Banks thereupon ignored and openly flouted the rules that "a lawyer who is in possession of funds belonging to another person incident to the lawyer's practice of law shall maintain such funds . . . in a special account or accounts, separate from any business or personal accounts of the lawyer or lawyer's firm, and separate from any accounts which the lawyer may maintain . . . in any other fiduciary capacity, in which special account or accounts all funds held in escrow or otherwise entrusted to the lawyer shall be deposited" [22 N.Y.C.R.R 1200.46(b)(1)], that the

account title of such "special account or accounts" must be such as "distinguishes such special account or accounts from other bank accounts that are maintained by the lawyer or the lawyer's firm" [22 N.Y.C.R.R 1200.46(b)(2)], and that such funds may be maintained only in Banks which agreed to be bound by the "Dishonored Check Reporting Rules" [22 N.Y.C.R.R. 1200.46(b)(1) and Part 1300]. * * * *

79H. Within the Attorney Disciplinary System, each Bank has **exclusive** control over the initial identification of each account opened by an attorney and how each attorney-depositor is, or is not thereafter, **permitted by the Bank** to utilize each account.

79I. When, as here, the Banks knowingly permitted an attorney to illegally open and/or utilize and deposit funds of other persons into such accounts which should [have] been, but are not, designated as "special", "escrow" or "trust" accounts in accordance with the applicable rules, and the Banks then hide behind the account mis-designation in order to evade the reporting of the 'bouncing" of hundreds of substantial checks drawn on those accounts, for "insufficient funds" – checks dwarfing in quantity and aggregate amounts the total of all other "bounced" checks reported throughout the State of New York – the Banks' misconduct (if not discovered) is not only "outcome-determinative" but, as in this case, results in the entire Attorney Disciplinary System being corrupted and undermined.

80. On various and sundry dates between 1992 and 1996 numerous checks, estimated to be in excess of 500 in number, drawn by Schick upon the Schick Attorney Fiduciary Accounts, aggregating at least $1 billion in total,

were received by the defendant banks at times when there were "insufficient available funds" in the accounts on which the checks were drawn to permit payment of the checks in the ordinary course of banking.

81. As more specifically alleged elsewhere in this Complaint, each Bank "covered" certain of the checks drawn on Schick's Attorney Fiduciary Accounts presented to it, with a resulting interest-free overdraft charged in each instance to the involved account.

82. As more specifically alleged elsewhere in this Complaint, each Bank dishonored ("bounced") certain of the checks drawn on Schick's Attorney Fiduciary Accounts presented to it, giving "insufficiency of available funds" as the stated reason for dishonor, **but failing to make dishonored Check Reports** to the Lawyers' Fund with respect to such checks.

83. As more specifically alleged elsewhere in this Complaint, each Bank dishonored ("bounced") certain of the checks presented to it, giving **no stated reason** for the dishonor, but returning the unpaid check to the presenting bank with the deceptive legend **"Refer to Maker"** deliberately stamped thereon, **and failing to make Dishonored Check Reports** to the Lawyers' Fund with respect to such checks.

84. At all times relevant hereto, each defendant had actual knowledge of the Dishonored Check Reporting Rules.

85. At all times relevant hereto, each defendant knew that issuance by Schick of checks drawn on any of the Schick Attorney Fiduciary Accounts, at a time or times when there were insufficient available collected funds to

pay the instrument(s), was serious professional misconduct which would subject Schick to suspension or disbarment.

86. At all times relevant hereto, each defendant knew that reporting the dishonor of Schick Attorney Fiduciary Account checks issued by Schick, at a time or times when there were insufficient available funds to pay the instrument(s), would result in the closing of those Schick Attorney Fiduciary Accounts maintained at each Bank.

87. At all times relevant hereto, each defendant knew that reporting the dishonor of Schick Attorney Fiduciary Account checks issued by Schick, at a time or times when there were insufficient available funds to pay the instrument(s), would result in Schick and/or Schick controlled entities defaulting on millions of dollars in loans owed to each Bank.

88. At all times relevant hereto, each defendant knew that reporting the dishonor of Schick Attorney Fiduciary Account checks issued by Schick, at a time or times when there were insufficient available funds to pay the instrument(s), would result in the loss of millions of dollars of anticipated future Schick business.

89. At all times relevant hereto, each defendant knew that reporting the dishonor of Schick Attorney Fiduciary Account checks issued by Schick, at a time or times when there were insufficient available funds to pay the instrument(s), would result in the collapse of Schick's "financial empire" and would potentially subject each Bank to multi-million dollar "lender liability" and other claims by defrauded investors.

90. At all times relevant hereto, each defendant knew that not reporting the dishonor of Schick Attorney Fiduciary Account checks issued by Schick, at a time or times when there were insufficient available funds to pay the instrument(s), would **prevent** the Lawyers' Fund, the DDC/DGC, and the Appellate Division from timely learning of Schick's serious professional misconduct and immediately "closing him down" by suspending and/or disbarring him from the practice of law.

91. Each defendant knowingly failed to report to the Lawyers' Fund presentation for payment and, in certain cases, the dishonor of Schick Attorney Fiduciary Account checks issued by Schick, at a time or times when there were insufficient available funds to pay the instrument(s).

92. Each defendant deliberately failed to report to the Lawyers' Fund presentation for payment and, in certain cases, the dishonor of Schick Attorney Fiduciary Accounts checks issued by Schick, at a time or times when there were insufficient collected funds to pay the instrument(s).

93. Each defendant intentionally failed to report to the Lawyers' Fund presentation for payment and, in certain cases, the dishonor of Schick Attorney Fiduciary Accounts checks issued by Schick, at a time or times when there were insufficient funds to pay the instrument(s).

94. The motive of each Bank in acting and/or failing to act as summarily alleged above (and alleged more specifically in detail elsewhere in this Complaint), was to perpetrate a "fraud on the [attorney disciplinary] system" so as to avoid investigation of Schick and his suspension and/or disbarment from the practice of law, and thereby

prevent the closing of accounts, loan defaults, loss of future business, and claims by Schick's investors.

* * *

99. Schick clients, including plaintiffs, entered into form "escrow agreements" with Schick and/or his then current law firm, providing in pertinent part that:

> WHEREAS, Escrow Agent is willing to serve as the holder of the Deposit on the terms and conditions described in this Escrow Agreement. . . .
>
> * * *
>
> 1. * * * The Deposit shall be held in escrow by Escrow Agent pursuant to this Agreement and shall at all times be deemed the sole and exclusive property and asset of Depositor, shall not be an asset or the property of Escrow Agent, or any third party and may not be hypothecated, pledged or assigned, nor serve as a deposit, fund, financial statement representation, or any other purpose, without the express written consent of Depositor in each instance.
>
> 2. The Deposit shall be deposited by Escrow Agent in an interest-bearing Attorney Trust Account at Fleet Bank. Escrow Agent shall furnish to Depositor (if Depositor requests same) copies of bank confirmations of the Deposit, and/or copies of bank statements for the account in which the Deposit is placed.
>
> * * *
>
> 6. In no event shall any of the sums deposited be paid or transferred to any other entity or

third party except as specifically provided in this Agreement.

* * *

8. Escrow Agent are attorneys admitted to practice in the State of New York and shall act as fiduciary in accordance with the relevant provisions of the Judiciary Law and all other ethical or legal standards for attorneys admitted to practice in the State of New York and expressly agrees that the only person who shall be entitled to, or have any right or interest in the Escrow Deposit shall be the Depositor."

* * *

134. Fleet's non-compliance with regard to the sending of Dishonored Check Reports to the Lawyers' Fund for "bounced checks" issued by Schick, totaling not less than $19,619,192.07, has corrupted the protections to which plaintiffs were entitled, and entitled to rely on, under Fleet's December 10, 1992 Agreement to Provide Dishonored Check Reports to the Lawyers' Fund. The bounced checks which Fleet did **not** report to the Lawyers' Fund, as aforesaid, are **greater** than the total amount of all bounced checks for all other lawyers in Fleet's system which it reported to the Lawyers' Fund for the period 1993-1996, and even greater than the total amount of all bounced checks of all attorneys.

* * *

149. * * * Fleet's subterfuge in dishonoring those checks and marking them "Refer to Maker" was knowingly false, dishonest, fraudulent, deceitful, misleading, and intentionally done by Fleet in order to corruptly evade its legal and contractual obligations to provide Notice of

Dishonored Check Reports to the Lawyers' Fund, to "corrupt" the Enterprise, as herein alleged, for Fleet's financial gain and in order to maintain Schick as an attorney in good standing and admitted to practice law in the State of New York so that (a) Fleet would not (i) suffer losses for the overdrafts in Schick's accounts, and (ii) lose the approximately $60-70 million per month deposited in the Hewlett Branch and profits earned in connection therewith, and (b) Fleet's fraud and corruption of the Enterprise, as herein alleged, by plaintiffs, would not be discovered, all of which would have occurred if Fleet had given Notice of Dishonored Check Reports to the Lawyers' Fund, and as a result thereof, Schick was suspended or disbarred from the practice of law by action of the Appellate Division of the Supreme Court of the State of New York as a member of The New York State Attorney Disciplinary System, the Enterprise alleged herein.

* * *

PLAINTIFFS' FINANCIAL TRANSACTIONS WITH SCHICK

190. Plaintiffs, in reliance upon (i) the fact that Schick was an attorney admitted to the practice of law in the State of New York in good standing, and (ii) the integrity of "The New York State Attorney Disciplinary System", which included the operations of defendants herein, to regulate Schick's conduct, as an attorney, and to discipline him for misconduct, entered into the following transactions with Schick and/or Schick controlled entities:

* * *

Dated: New York, New York
November 15, 1999

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-and-

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By: _____
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Edward S. Rudofsky (ER - 9037)
Eric S. Horowitz (EH - 1815)
Arlene H. Schechter (AS - 9175)

Attorneys for Plaintiffs